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No. 20553

In the

United States Court of Appeals

For the Ninth Circuit

ANGUS J. DEPINTO,
Appellant,

and

JAMES P. DONOHUE, as Trustee in Bankruptcy of the Estate of Angus J. DePinto,
Intervenor-Appellant,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and ALBERT J. DOIG,
Appellees.

Opening Brief of Appellant, Angus J. DePinto, and Intervenor-Appellant, James P. Donohue

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(For convenience, the individual parties will be referred to by their last names. Provident Security Life Insurance Company will be referred to as "Provident". United Security Life will be referred to as "United", American Security Investment Company will be referred to as "American". "T.R." refers to Transcript of Record; "R.T." refers to Reporter's Transcript; "O.T." refers to the Original Transcript of Record in Cause No. 18245.)

A.

JURISDICTION

This Action originated in the United States District Court for the District of Arizona as a shareholders' derivative action. Jurisdiction was based on 28 U.S.C.A. § 1332. (T.R. 1) From an adverse judgment, DePinto instituted this appeal pursuant to Rule 73 of the Federal Rules of Civil Procedure. 28 U.S.C.A. § 1291 grants to this Court jurisdiction to review the judgment of the lower Court.

B.

STATEMENT OF THE CASE

1. Proceedings in Lower Court.

This action was instituted by one John S. Gorsuch against United Security Life, James E. Kelly, L. N. Kelly, Patrick J. Kelly, Nina Dunn, J. L. Jenkins, Angus J. DePinto, Elmer W. Duhame, American Security Investment Co., Roslyn B. Croydon, Vernon E. Niesz, John D. Ballantyne, Edwin B. Pegram and United Finance Corporation. By his amended complaint, Gorsuch sought to recover on behalf of United the sum of $463,238.33, consisting of (1) $45,514.51, alleged to have been paid by United to James E. Kelly after he had resigned as an officer and director of United, (2) $109,723.82, alleged to have been disbursed by United to United Finance Corporation, and (3) the sum of $308,000, alleged to have been transferred from United to American Security Investment Co. in return for 30,800 shares of the latter's stock. (T.R. 1) The case was tried to a jury which returned a special verdict in favor of DePinto. (O.T. 304) The trial Judge, nevertheless, entered judgment against DePinto and in favor of United for the sum of $314,794.19. Judgment for a like amount was entered against the other individual defendants, excepting that, in the case of James E. Kelly, L. N. Kelly, Nina Dunn, J. L. Jenkins, John D. Ballantyne and Roslyn B. Croydon, the judgment was

limited to $308,000, as the result of stipulations entered into between them and plaintiff prior to trial. The claim based upon alleged disbursements to Kelly (stated in the complaint as $45,514.51, and in the pretrial order as $46,839.51), and the claim based upon the alleged disbursement by United of $109,723.82 to United Finance Corporation, were dismissed on the merits and with prejudice. (T.R. 24, O.T. 354)

A number of the defendants, including DePinto, appealed to this Court (Cause No. 17114), and the judgment was reversed in *Niesz v. Gorsuch*, 295 F.2d 909 (9th Cir. 1961). Upon remand to the District Court, further proceedings were had including the joinder of Provident (aligned by the trial Court as a defendant), and Albert J. Doig, as plaintiff. The complaints filed by Provident and Doig each sought to recover from the defendants, and on behalf of Provident, the sum of $314,794.19, on account of assets which were alleged to have been transferred from United to American on or about October 18, 1957. (T.R. 26, 44) Another judgment (the second) was entered against the defendants, including DePinto. (O.T. 1746) A second appeal was taken to this Court (Cause No. 18245) and, again, there was a reversal. *DePinto v. Provident Security Life Insurance Company*, 323 F.2d 826 (9th Cir. 1963).

Upon remand, the case was set for trial before a jury as to the defendants DePinto, Landoe, Sabo, Pegram, and the Executors of the Estate of Elmer W. Duhame, deceased. (T.R. 288) On the eve of trial, the Duhame Executors agreed to pay to Provident the sum of $100,000, in consideration of a covenant-not-to-sue. (T.R. 206-234, 267) At the request of plaintiff Doig, and over the objection of DePinto, the trial Court entered an order severing the cause as to the remaining defendants, Sabo, Pegram and Landoe, and ordering that the case would proceed to trial against DePinto as the sole defendant. (R.T. 166-171; T.R. 292) After the introduction of all evidence, DePinto moved for a

directed verdict. (R.T. 551; T.R. 292) This was denied and the jury returned a verdict in favor of Provident and against DePinto in the sum of $314,794.19, upon which the Court entered judgment. (T.R. 235, 262) DePinto, pursuant to the provisions of Rule 50(b) of the Federal Rules of Civil Procedure, moved for judgment in accordance with his motion for directed verdict or, in the alternative, for a new trial. (T.R. 254, 263) Upon the denial thereof, this appeal was instituted. (T.R. 273, 274)

Subsequent to the institution of this appeal, DePinto was adjudicated a bankrupt and James P. Donohue was appointed as Trustee in Bankruptcy of the DePinto Estate. On the 15th of June, 1966, an order was entered herein granting the Petition of the Trustee to intervene herein.

2. Facts.

In the year 1952, Kelly organized United as a Stock Life Insurance Company, under the laws of the State of Arizona. From the time of its organization until October 18, 1957, the management of United was under the direction and control of Kelly, although he resigned as President and Director in July of 1956. (R.T. 185, 206) Of a total of 100,000 shares of United stock outstanding, Kelly owned 35,149 shares, which gave him control. (R.T. 209, 305)

DePinto has practiced medicine in Phoenix, Arizona since 1936 as a specialist in obstetrics and gynecology. He and Kelly became friends in 1947. (R.T. 494) As a result of that friendship, and at the request of Kelly, DePinto became a member of the Board of Directors of United on October 14, 1955. His purpose in consenting to become a member of the Board of Directors of United was to help Kelly. He did not intend to be an active member of the Board, and did not attend meetings of the Board. (R.T. 197-199, 208-209, 314, 495)

In the early part of 1957, Kelly retained Croydon and Frederick Heineman, a lawyer, to sell his stock in United on a com-

mission basis. (R.T. 291) On October 17, 1957, American was organized under the laws of the State of Arizona, with Sabo, Pegram, Landoe, Croydon, Niesz and Ballantyne as incorporators. (R.T. 210)

A few days prior to October 18, 1957, Kelly told DePinto that some reputable people—insurance people and a doctor from Montana—were buying his stock in United. He advised DePinto that the purchasers intended to increase the surplus of the company up to $260,000; that the money for the purchase of his stock was coming from Dr. Sabo and the other investors. (R.T. 292, 498, 511) Kelly suggested to DePinto that he resign from the Board of United, because of the imminent sale of Kelly's stock and the transfer of control to the purchasers. (R.T. 210-211) A resignation from the Board of Directors of United was signed by DePinto on October 17 or 18, 1957. (R.T. 311) The minutes of a meeting of the Board of Directors of United held on October 18, 1957, at 4:00 P.M., disclose that directors Dunn, DePinto and Jenkins adopted a resolution reading as follows:

> "RESOLVED that the resignations of A. Thomas Duncan, Patrick J. Kelly, E. Hartley Brown, T. J. Flaherty, and Spence Reese as directors of United Security Life be and they are hereby accepted.
>
> "RESOLVED that Vernon E. Niesz, John D. Ballantyne, Roslyn B. Croydon, Frank I. Sabo, Edwin B. Pegram and Harry T. Goss be and they are hereby elected directors of United Security Life, each to serve until the annual meeting of shareholders in 1958, or until his resignation, or death, or until his successor is elected, whichever is earliest." (Ex. 5G)

At a meeting of the Board of Directors of United held at 4:15 P.M. on October 18, 1957, DePinto's resignation as a member of United's Board of Directors was accepted. (R.T. 518) The minutes of said meeting read, in part:

"On motion made, seconded and unanimously carried, it was

"RESOLVED that the resignations of N. J. Dunn, J. L. Jenkins and Angus J. DePinto, M.D., be and they are hereby accepted.

* * * * * * *

"RESOLVED that the corporation subscribe for 30,800 class A common shares of American Security Investment Co. at a price of $10.00 per share to be purchased immediately for a total consideration of $308,000.00 consisting of assets now owned by the corporation and cash referred to in the following items numbered 1 through 6:

"1. Note and first mortgage made by Mrs. H. M. McKinley and having a present unpaid balance of principal and interest of $33,424.12.

"2. Note and first mortgage made by Forrest R. and Lois Newville and having a present balance of principal and interest of $10,874.35.

"3. Bonds having a present book value of $16,370.18 as follows:

* * * * * * *

"4. Certificates of deposit having a total present value of $127,012.50 as follows:

* * * * * * *

"5. Three promissory notes made by United Finance Corp. having a present unpaid balance of principal and interest aggregating $87,626.88.

"6. Cash of $32,691.97.

"RESOLVED that the corporation subscribe for 4,200 class A common shares of American Security Investment Co. at a price of $10,000 per share to be purchased on or before February 1, 1958, for a total consideration of $42,000.00 to be paid in cash on or before February 1, 1958.

"RESOLVED that the president and secretary of the corporation be and they are hereby authorized and directed to effect the sale and the purchase referred to herein, and to execute any and all contracts, instruments, checks or other

papers deemed necessary or desirable by them to consummate said transactions on behalf of the corporation." (Ex. 5H)

After October 18, 1957, DePinto had nothing to do with the affairs of United. Kelly did not offer DePinto any money or anything of value for his resignation from the Board of Directors. DePinto did not receive any of the proceeds from the sale of Kelly's stock. DePinto did not receive any money, benefit or compensation for his services as a Director of United. DePinto had no interest in American and did not receive any of the assets transferred from United to American. (R.T. 313-314, 495, 500-501)

On October 18, 1957, the Board of Directors of American adopted resolutions:

(a) That American sell to United 30,800 class A common shares of American for a consideration of $308,000, consisting of the assets referred to and described as items 1 through 6 in the United minutes of October 18, 1957, and hereinabove quoted from Exhibit 5H;

(b) That American sell to United 4,200 shares of its class A common stock for the sum of $42,000, to be paid in cash on or before February 1, 1958;

(c) That American accept the offer of James E. Kelly to sell 35,149.89 shares of United stock to American for $9.25 a share, and that American pay Kelly therefor by transferring to him the above-mentioned assets of United, plus additional cash in the amount of $17,136.48;

(d) That American accept the offer of United Family Guild to sell 3,650 common shares of United to American at $9.25 a share, payable in cash. (Ex. 50N)

On the same date, American entered into an agreement with Kelly, whereby American agreed to purchase from Kelly 35,149.89

shares of the stock of United, at a purchase price of $325,136.48. Among other things, said agreement provided:

> "3. TERMS: Said purchase price of $325,136.48 will be paid on or before 5:00 P.M., Friday, October 18, 1957, at the time of the delivery of said shares. Said purchase price will be paid by American as follows:
>
> "(a) Cash in the amount of $176,840.95;
>
> "(b) Bonds of the value of $16,370.18;
>
> "(c) Existing notes and mortgages owed by Kelly in the amount of $131,925.35." (Ex. 58)

At the same time, American entered into an agreement with Kelly to purchase certain accounts due agents of United (which Kelly had purchased), for the sum of $12,246.40, payable in stock of American. (Ex. 59) Also, at the same time, American entered into an agreement with United Family Guild to purchase 3,650 shares of the stock of United for the sum of $33,762.50 (Ex. 60)

The above-mentioned minutes of Boards of Directors meetings and rought drafts of the aforesaid agreements (Exs. A, B, and C), were prepared by Frederick Heineman. (R.T. 416, 424, 449) These documents were brought by Heineman to a meeting held in the law office of Jennings, Strouss, Salmon & Trask, Phoenix, Arizona, on October 18, 1957. (R.T. 433, 437) Among those present at the meeting were Mr. Earl Glenn, Frank Campbell and Riney Salmon of that firm. Also present were Croydon, Niesz, Ballantyne, Kelly and Dunn. Attorneys Frederick Heineman and Harry Goss were also present. (R.T. 300, 318, 323, 436) The drafts of the above-mentioned agreements were rewritten in the Salmon office. The contracts in final form were signed in the Salmon office. (R.T. 433, 435-436) Prior to the execution of the contracts, Heineman and Salmon had a discussion with respect to the legality of the transactions reflected in said contracts. (R.T. 442, 443, 456) Heineman and Salmon had no "legal misgivings" about the transaction. (R.T. 456)

On October 18, 1957, and pursuant to the above-mentioned agreements and resolutions of Boards of Directors, the following took place:

> United transferred to American cash in the amount of $6,794.19, and assets hereinabove described having a face value of $308,000. (R.T. 212-214)
>
> United received from American 30,800 shares of the Class A non-voting common stock of American.
>
> The above-mentioned assets having a face value of $308,000, together with a check for $17,136.48, were delivered by American to Kelly. (R.T. 212-214, 330)

Had DePinto made an investigation of the various parties involved in the above-mentioned transaction, he would have learned:

Croydon was an actuary who had done work for the Insurance Department of the State of Arizona and several other large companies in the State and out of State. (R.T. 306) Ballantyne and Niesz were associated with Croydon and they were all "top people". Niesz was president of an Arizona insurance company and had an excellent reputation. (R.T. 309) Fred Heineman practiced law in Illinois and Arizona since 1931, specializing in insurance law. When Heineman came to Phoenix in 1954, he worked for Great Southwest Life Insurance Company, and after being admitted to the Arizona Bar in 1956, he incorporated and represented, perhaps, half a dozen life insurance companies. (R.T. 309-310) Riney Salmon, Frank Campbell and Earl Glenn were partners in the law firm of Jennings, Strouss, Salmon & Trask. Mr. Campbell's reputation for integrity, truth and veracity was the best. Mr. Salmon's reputation for professional ability and for integrity was the best. Earl Glenn was a former director of Securities for the Corporation Commission of the State of Arizona. (R.T. 307-310)

3. Questions.

The questions involved in this appeal are as follows:

1. Is there any evidence from which the jury was justified in finding that DePinto was guilty of negligence, which constituted a breach of his fiduciary duty as a director of United, and which proximately caused or contributed to cause the alleged loss to United resulting from the transfer of certain of its assets to American in exchange for American stock?

2. Is there any evidence from which the jury was justified in finding that United was damaged in the amount of $314,794.19, or any other amount, as the proximate result of any act or omission of DePinto as a member of the Board of Directors of United?

3. Did the trial Court err in the admission of evidence over the objection of DePinto?

4. Did the trial Court err in the rejection of evidence offered by DePinto?

5. Did the trial Court err in its instructions to the jury?

6. Did the trial Court err in failing to instruct the jury in accordance with the request of DePinto?

7. Did the trial Court err in giving instructions to the jury during their deliberations and not in open Court?

8. Was the judgment rendered against DePinto excessive in the following respects:

(a) As the result of the cancellation of 38,798 shares of United stock held by American and the surrender by the Duhame Estate of the right to participate in any recovery herein to the extent of 3,750 shares of stock, should the claim of $314,794.19 have been reduced to 57,452/100,000 thereof, namely $180,856.00.

(b) Should the claim against DePinto be reduced by the sum of $100,000, paid by the Duhame Executors in settlement of the claims against the Duhame Estate.

(c) Should any judgment against DePinto bear interest from October 18, 1957, or from the date of entry of judgment.

(d) In view of the entry of judgment against James E. Kelly and L. N. Kelly, Dunn, Jenkins, Croydon and Ballantyne in the amount of $308,000, and pursuant to stipulation, was DePinto discharged from all liability in excess of that amount.

9. Did the trial Court err in severing the action as to the defendants Sabo, Pegram and Landoe, and by permitting the trial of the action to proceed against DePinto alone?

10. Was DePinto deprived of a fair trial by reason of the failure of the trial Judge to withdraw from the case after the filing of an Affidavit of Bias or Prejudice?

C.

SPECIFICATIONS OF ERROR

Specification of Error No. 1.

The trial Court erred in denying DePinto's Motion for Directed Verdict made at the close of all of the evidence for the reasons that:

(a) Plaintiff failed to prove the material allegations of his complaint;

(b) The undisputed evidence discloses that acts or omissions of DePinto, as a Director of United, did not proximately cause or contribute to cause any loss or damage to United; and

(c) There was no evidence from which the jury could have determined damages sustained by United other than by conjecture and speculation.

Specification of Error No. 2.

The trial Court erred in the admission of evidence over the objection of appellant, including:

(a) Facts and circumstances unrelated to the transaction of October 18, 1957, and

(b) Incompetent evidence relative to damages.

The full substance of the admitted evidence and the grounds urged at the trial for the objections thereto are set forth in Appendix "A", page 1.

Specification of Error No. 3.

The trial Court erred in rejecting evidence offered by appellant, including:

(a) Plans of the Niesz group and their consultations with lawyers and public officers;

(b) The reputations and backgrounds of members of the Niesz group; and

(c) Evidence as to damages.

The full substance of the rejected evidence and the grounds urged at the trial for the objections thereto are set forth in Appendix "B", page 7.

Specification of Error No. 4.

The trial Court erred in its charge to the jury. The portions of the Court's charge to the jury to which appellant objected are set forth *totidem verbis,* together with the grounds of the objections urged at the trial, in Appendix "C", page 23.

Specification of Error No. 5.

The trial Court erred in failing to charge the jury in accordance with the requested instructions of appellant. The requested in-

structions which were rejected by the trial Court are set forth *totidem verbis*, together with the grounds of the objections urged at the trial Court, in Appendix "D", page 29.

Specification of Error No. 6.

The trial Court erred in giving instructions to the jury during their deliberations and not in open Court, particularly:

"The three items of claimed damage are:

1) Cash, by check or bank certificates of deposit	$166,498.66
2) Promissory notes and accrued interest thereon	87,626.88
3) Mortgages, bonds and accrued interest thereon	60,668.65
Total	$314,794.19"

Specification of Error No. 7.

The trial Court erred in failing to limit the judgment entered against DePinto to an amount not exceeding $80,856, for the reasons:

(a) Under the terms of the merger agreement between Provident and United, and as a result of the settlement with the Duhame Executors, the former holders of United stock who will share in any recovery herein represent ownership of only a fraction (57,452/100,000) of United stock originally issued and outstanding. Therefore, the right of Provident to secure a judgment on behalf of the former United stockholders, who will share therein, is limited to 57,452/100,000 of the total claim, namely $180,856.

(b) DePinto and Duhame were sued in this action as joint tortfeasors; therefore, DePinto is entitled to a credit in the amount of $100,000, on account of the settlement made by the Duhame Executors in that amount. With the

application of that credit, the amount of any judgment which might have been entered against DePinto could not legally exceed the sum of $80,856.

(c) Any judgment entered against DePinto could not legally bear interest commencing at a date earlier than the date of the entry of judgment for the reason that the claim against DePinto herein was unliquidated.

(d) In no event could any judgment be legally entered herein against DePinto in excess of the sum of $308,000, for the reason that James E. Kelly, L. N. Kelly, Nina Dunn, J. L. Jenkins, Roslyn B. Croydon and John D. Ballantyne, who were originally charged herein with DePinto as joint tortfeasors, were, pursuant to agreements and stipulations entered into on or about March 9, 1960, and by reason of a judgment entered herein on or about June 21, 1960, released and discharged of all liability for any claims made against them and DePinto jointly, in excess of $308,000.

Specification of Error No. 8.

The trial Court erred in severing the claim made by plaintiff against DePinto from the claim made against Sabo, Pegram and Landoe for the reasons:

(a) It permitted plaintiff to proceed against a party secondarily liable (if at all) in the absence of parties primarily liable.

(b) It ignored appellant's cross-claim against Sabo, Pegram and Landoe.

(c) DePinto was thereby left alone in the case as "the target" defendant.

(d) It resulted in the absence of parties whose testimony would have been helpful to DePinto.

(e) Severance is not authorized where there has been a proper joinder of parties.

Specification of Error No. 9.

The trial Judge erred in failing to withdraw from the case after the filing of an Affidavit of Bias or Prejudice by DePinto for the reason that his failure so to do resulted in DePinto being deprived of a fair trial in violation of his rights guaranteed by the 5th Amendment to the Constitution of the United States.

Specification of Error No. 10.

The trial Court erred in failing to grant DePinto's Motion for Judgment (pursuant to Rule 50(b), Federal Rules of Civil Procedure), for the reasons stated in Specification of Error No. 1.

Specification of Error No. 11.

The trial Court erred in failing to grant DePinto's Motion for a New Trial (pursuant to Rule 59, Federal Rules of Civil Procedure), for the reasons stated in Specifications of Error Nos. 1 to 8, inclusive.

D.

ARGUMENT

1. Verdict Not Supported by Evidence (Question No. 1. Specifications of Error Nos. 1 & 10.)

Although we have made numerous specifications of error, we submit that this appeal may be, and should be, disposed of by a determination that the verdict is not supported by the evidence. It is our position that: (1) the undisputed evidence discloses that any loss which may have been sustained by United as the result of its exchange of assets for stock in American was not proximately caused or contributed to by any act or omission of DePinto as a director of United, and (2) there is no competent evidence of the amount of loss or damage sustained by United, if any, as a result of the aforesaid transactions; the verdict was necessarily the result of speculation and guess upon the part of the jury.

(a) PROXIMATE CAUSE

By Count VI of the Doig Complaint, it is alleged that DePinto and others "caused defendant United Security Life to transfer $314,794.19 of the latter's liquid reserves to defendant American Security Investment Company in return for 30,800 shares of the latter's stock, which stock was worthless and had no fair market value". It was also alleged that DePinto and others "breached their fiduciary duty and responsibilities to defendent United Securities by permitting defendant United Security Life to enter into an agreement whereby $314,794.19 of defendant United Security Life's assets were transferred in exchange for worthless stock to the benefit of defendant James E. Kelly and L. N. Kelly." (T.R. 39-40) By Count VII of the Complaint, it is alleged that DePinto and others "acting as directors of defendant United Security Life, negligently transferred the control of defendant United Security Life to the defendants American Security Investment Company, Roslyn B. Croydon, Vernon E. Niesz, John D. Ballantyne, Edwin B. Pegram, Francis I. Sabo and Hjalmer B. Landoe who thereafter proceeded to loot the defendant United Security Life of its liquid reserves." (T.R. 40-41)

The facts are undisputed that DePinto participated in the election of Vernon E. Niesz, John D. Ballantyne, Roslyn B. Croydon, Francis I. Sabo, Edwin B. Pegram and Harry T. Goss to the board of directors of United (Ex. 5G; R.T. 215). It is also undisputed that at a meeting of the board of directors of United held at 4:15 P.M. on October 18, 1957, the resignation of Dr. DePinto as a member of the board of directors of United was accepted (R.T. 518) and, thereafter, the board adopted resolutions authorizing the purchase of 35,000 Class A common shares of American Security Investment Company, to be paid for by cash and other assets of United. (Ex. 5H) It is this transaction of which complaint is made in Counts VI and VII of the Complaint. It is clear that the evidence does not support the allegations of Count VI of the

Complaint for the reason that DePinto did not "cause" or "permit" United to transfer its assets to American. He was not a member of the board of directors of United when such transaction took place, and did not participate therein in any way, shape or form. We are, therefore, concerned only with the allegations of Count VII to the effect that DePinto and others negligently transferred control of United to the Niesz group who "proceeded to loot the defendant United Security Life of its liquid reserves."

We concede that a director of a publicly-held stock corporation occupies a fiduciary relationship to the corporation and its stockholders; that a director may be held liable to the corporation for losses to it which are the proximate result of his negligence; that lack of knowledge of, or inattention to, the affairs of the corporation, may constitute negligence. The critical fact, however, is that inattention by DePinto had no causal connection with the acts of the succeeding directors (in which DePinto did not participate and which he had no duty or power to permit or prohibit) in removing assets from United. In the case of *Barnes v. Andrews*, 298 F. 614 (D.C.S.D.N.Y. 1924), the respected Judge Learned Hand stated, commencing at page 616:

> "Therefore I cannot acquit Andrews of misprision in his office, though his integrity is unquestioned. The plaintiff must, however, go further than to show that he should have been more active in his duties. This cause of action rests upon a tort, as much though it be a tort of omission as though it had rested upon a positive act. *The plaintiff must accept the burden of showing that the performance of the defendant's duties would have avoided loss, and what loss it would have avoided. * * * The defendant is not subject to the burden of proving that the loss would not have happened, whether he had done his duty or not.*" (Emphasis supplied.)

It is elementary that persons are liable as corporate directors only where they were directors at or during the time of the act or

omission relied on as creating liability. 3 *Fletcher, Encyclopedia of Corporations,* 49 et seq. §§ 994, 996, 1082. In the case of *Pritchard, et al. v. Myers,* 174 Md. 66, 197 A. 620 (1938), the Court of Appeals of Maryland said at page 624:

> "The defendant, who ceased to be a director, cannot be made liable for subsequent acts * * *."

In the case of *Angelus Securities Corp. v. Ball,* 20 C.A.2d 423, 67 P.2d 152 (1937), the Court stated, commencing at page 157:

> "* * * The record is barren of any evidence showing that either Luton or Cruickshank took any part in this transaction or received any part of the secret profit. Ordinarily, the only grounds upon which directors or other officers can be held liable for the acts of other officers are that (1) they participated therein, or (2) were negligent in supervising the corporate business, or (3) were negligent in the appointment of the wrongdoer. It need hardly be said that one cannot be held liable as director for wrongs of other corporate officers or agents after he has ceased to sustain the relation of director to the corporation. 3 Fletcher Cyc. Law of Private Corporations (perm. Ed.) pp. 481, 497, Secs. 1069, 1082. It is not claimed that defendants Luton and Cruickshank ever made any profit out of the sale by Ball of the securities in question to Harriss or shared in any way in the illegal profit alleged to have been made. Assuming that there was fraud in the transaction, if legal wrong to the company was there done, it could only be material here as to the respondents Luton and Cruickshank if they were parties to it. Not having been participants therein, either directly or indirectly, no liability, in our opinion, can be put upon them. * * *"

The case of *Minnis v. Sharpe,* 203 N.C. 110, 164 S.E. 625 (1932) is directly in point. We quote from page 625.

> "In the absence of evidence tending to show a causal connection between the negligence of the defendant, James N. Williamson, Jr., while serving as a director of the Alamance Insurance & Real Estate Company, and the loss sus-

tained by plaintiff's intestate by reason of the negligence of the directors of said company, after the defendant had ceased to be a director, it was error to refuse defendant's motion for judgment as of nonsuit at the close of all the evidence. Burke v. Carolina Coach Co., 198 N.C. 8, 150 S.E. 636; Whitaker v. Carpenter Motor Car Co., 197 N.C. 83, 147 S.E. 729; Peters v. Great Atlantic & Pacific Tea Co., 194 N.C. 172, 138 S.E. 595; Gillis v. Transit Corporation, 193 N.C. 346, 137 S.E. 153; Ledbetter v. English, 166 N.C. 125, 181 S.E. 1066."

If DePinto is to be charged with liability for the acts of the Niesz group, it can only be upon the theory that he participated in the election of the members thereof to the board of United. when he knew, or should have known, that they were persons who, by reason of past conduct, could be expected to carry on the affairs of United in a negligent or wrongful manner. Throughout the numerous trials and appeals of this case, counsel for Doig have insisted that the case of *Insuranshares Corporation v. Northern Fiscal Corporation*, 35 F. Supp. 22, 42 F. Supp. 126 (D.C. E.D. Pa. 1941) is the guidepost which leads to a finding of liability upon the part of DePinto. To the contrary, the language of Judge Kirkpatrick discloses why DePinto cannot, in this case, be held liable for the acts of the Niesz group:

> "The fault of the defendants lay in turning over control of the plaintiff corporation to a group who they knew or could by the exercise of reasonable care have known *would not be restrained by any scruples* from abstracting some half million dollars from the plaintiff's treasury to raise the sum from which to pay the defendants the purchase price of their stock. (42 F. Supp. 126)"

The record herein discloses no evidence whatsoever which suggests that, had DePinto made an investigation, he would have discovered that any member of the Niesz group was unscrupulous or other than a reputable and respected business or profes-

sional man. The language of the Court, in the case of *Benson v. Braun,* 155 N.Y.S.2d 622 (1956), at page 262, is apposite:

> "On this phase of their case, plaintiffs have failed to establish that the individual defendants sold to persons who they *knew* 'had previously looted' the corporation and who 'had otherwise breached their trust while directors'. The sellers could only know that which was established as a fact."

In the case of *Briggs v. Spaulding,* 141 U.S. 132, 11 S.Ct. 924, 35 L.Ed. 662, the Supreme Court of the United States affirmed a judgment of the Circuit Court dismissing a suit in equity to recover loss and damage sustained by a bank as a result of neglect of duty of the directors. The bank, being then insolvent, suspended business on April 14, 1882. The defendants Spaulding and Johnson became members of the board of directors of the bank on January 10, 1882, and they participated in the election of the former cashier, Lee, as president of the bank. Neither Johnson nor Spaulding paid any attention to the affairs of the bank. The bank was rendered insolvent by reason of Lee's discounting of the paper of persons engaged with him in outside business and speculation, who were not adequately responsible for their engagements. The Supreme Court said:

> *"Treated as a cause of action in favor of the corporation, a liability of this kind should not lightly be imposed in the absence of any element of positive misfeasance, and solely upon the ground of passive negligence; and it must be made to appear that the losses for which defendants are required to respond were the natural and necessary consequences of omission on their part.* (Emphasis supplied.)
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> * * * * * * *
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> "We pass, then, to the inquiry as to the liability of defendants Spaulding and Johnson. In what did their negligence consist, and were losses occasioned by that negligence, and what losses? Their conduct is to be judged, not by the event, but by the circumstances under which they acted.

* * * * * * *

"Were these defendants guilty of negligence in allowing Lee to remain in charge of the bank? Would they have been so guilty if they had put him in charge for the first time on the 10th of January?

* * * * * * *

"His general character was good, his reputation for integrity and financial capacity excellent, and he possessed the confidence of his fellow-citizens. Upon the 10th of January, 1882, he was the owner of two thirds of the stock of the bank, and had apparently a greater interest than any other person in seeing that its affairs were so managed that its capital would remain unimpaired. The business of the bank had been conducted for years by the president, assisted by the other executive officers, and it had seemingly been well conducted. Lee was selected to assume the management when Charles T. Coit retired in October, 1881, by the then board of directors, and there was nothing to indicate that the choice was not a proper and fit one. We think no jury would have been justified in finding defendants guilty of negligence in retaining Lee in the management of the bank."

Although the Supreme Court did not expressly predicate its opinion upon a lack of proximate cause between the inattention of Johnson and Spaulding and the loss resulting to the bank from Lee's activities, such predicate is implicit in its decision. In the case at Bar, DePinto can no more be held liable for the acts of the Niesz group than were Johnson and Spaulding held liable for the acts of Lee. There is nothing in the record to contradict the presumption* that it could be said of each member of the Niesz group that "his general character was good, his reputation for integrity and financial capacity excellent, and he possessed confidence of his fellow-citizens". The trial Judge excluded DePinto's offer to prove that the members of the Niesz group were

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*31A *C.J.S. Evidence,* §§ 122, 126, 150E.

men of excellent reputation for professional ability and integrity. (R.T. 469, 477, 523) The limited evidence which the trial Judge permitted DePinto to place before the jury disclosed that Croydon, Niesz and Ballantyne were insurance men of good reputation and that the attorneys who prepared the documents and handled the closing of the transaction between United, American and Kelly on October 18, 1957, were men of ability, integrity and good reputation. (R.T. 309-310)

The case of *Michelson v. Penney,* 135 F.2d 409 (2 Cir., 1943) is most enlightening upon the question of proximate cause. The well-known J. C. Penney was sued by a depositors' committee of the City National Bank of Miami, Florida, of which Penney was chairman of the board to recover losses claimed to have been caused by his violation of duty as a director. During the three years that Penney served as a director, he attended only three out of thirty-one meetings of the board. Among other things, Penney was charged with a violation of 12 U.S.C.A. § 72, which requires every bank director to own stock in his own right. With respect to whether or not Penney's violation of the statute was the proximate cause of loss to the bank, the Court stated:

> "*Each standard of liability still requires, however, a causal connection between the act interdicted and the loss.* It is because of that requirement that we do not agree with the district court in holding defendant as an insurer by reason of the qualification of dummy directors. That there was a violation of statute seems clear. 12 U.S.C.A. § 72 requires every director of a bank such as this to 'own in his own right' shares of the bank's capital stock of which the aggregate par value shall not be less than $1,000, and provides that a director ceasing to own the required shares 'shall thereby vacate his place.' To all intents and purposes, Penney-Gwinn was the substantial owner of the stock who had supplied the money and who took the risk of loss; indeed, Penney-Gwinn ultimately paid the assessment levied on these shares of stock. But that violation of itself does not show loss to the bank.

It was not shown, for example, that irresponsible or untrustworthy men were placed on the Board and that they proceeded forthwith to loot the bank's exchequer. On the contrary, the evidence supports the conclusion that the directors were all known and esteemed business men. Conceivably there may arise cases where specific losses can be traced to a violation of this statute, but that is not the present case." (Emphasis supplied.)

Appellees will, no doubt, take the position that, even though the record fails to disclose that members of the Niesz group had reputations for negligent business conduct, the circumstances surrounding the surrender of control of United to them was such as to put DePinto upon inquiry as to their intentions. We are not aware of any decisions which require that a director in the position of DePinto make an exhaustive inquiry as to the intention of the directors who succeed him. If this were so, a retiring director could participate in the election of competent and reputable men, only to be held liable for their acts committed months thereafter because of his alleged failure to ascertain their plans with respect to the conduct of the corporate business. There was nothing inherent in the proposal of Kelly to sell his stock in United and cause the control of United to be transferred to the purchasers, which would have put a reasonably prudent director upon inquiry, beyond the point of ascertaining that the new directors were not thieves or incompetents. The fact that Kelly intended to sell his stock in United would not raise any suspicion that the purchasers intended to wrongfully extract assets from United in order to pay the purchase price. When a group of investors are acquiring a large block of stock in a corporation which will give them *de facto* control thereof, there can be nothing surprising, suspicious or sinister about the fact that they desire to take over management of the corporation forthwith. As stated in *Benson v. Braun*, 155 N.Y.Supp.2d 622, 625:

> "When ownership of controlling stock changes hands, a change in the board of directors is generally expected. * * * Thus, it is legitimate for those selling controlling shares, in connection with the sale of their stock, to resign as directors and to use their influence to bring about resignations by a majority of the board so as to facilitate the taking over of control by the purchasers."

(b) DAMAGES

It is undisputed that, on October 18, 1957, there were transferred from United to American assets having a face value of $308,000, for which United received 30,800 shares of the common stock of American. Upon said date, United also transferred to American cash in the amount of $6,794.19. (R.T. 212-215) Included in said assets were two mortgages, executed by individuals, having an aggregate face value, including interest, of $44,298.47. There were also promissory notes of United Finance Corporation in the face amount of $86,000. In his instructions to the jury, the trial Court stated:

> "In your computation of damages, the value if any, you find of the American Security Investment Company stock received by United Security Life, as disclosed by the evidence, should be deducted from your findings as to the amount of the value of the assets transferred to Kelly." (R.T. 587)

In the light of the verdict, the jury presumably determined that the assets were worth $314,794.19, and that the 30,800 shares of American stock received by United were valueless.

Not only was there no competent evidence that United's assets were worth $314,794.19, but the only evidence bearing on the question discloses that such assets were *not* worth that amount. Included in the list of assets were promissory notes of United Finance Corporation in the principal amount of $86,000, with accrued interest of $1,626.88, a mortgage of H. N. McKinley in the principal amount of $31,851.21, with accrued interest in

the amount of $1,572.91, and a mortgage of Forrest R. Newville in the principal amount of $10,816.67, with accrued interest in the amount of $57.68. (R.T. 212) In the agreement between American and Kelly (Ex. 58), these items, aggregating $131,-925.35, were described as:

> "(c) Existing notes and mortgages *owed* by Kelly in the amount of $131,925.35."

Obviously, the obligations of McKinley, Newville and United Finance Corporation were, in reality, the obligations of Kelly, which he was willing to accept at face value, but which would have been of questionable value in the hands of anyone else. As pointed out by Croydon, 38% of the stock of United had a value of $405,000, "If you could pay for it—partially pay for it with accounts receivable. In other words, with what I would term *questionable assets.*" (R.T. 375) That the assets were "questionable" is borne out by the testimony of Guy Hammet, Examiner for the Arizona Insurance Department. He testified that, on October 17, 1957, there was a deficit in the capital stock and surplus of United. (R.T. 263, 266) "That was because $86,000 in non-admitted assets were advanced to United Finance." (R.T. 268)

Appellees will, no doubt, argue that the assets transferred to American by United had a value of $314,794.19, because the books of United showed a deficit in surplus as of December 31, 1957, of $351,844.56, and Hammett testified that such deficit was the result of the transfer of $308,000 of United assets on October 18, 1957. (R.T. 264-265) The conclusion sought by Appellees does not follow from Hammett's testimony, for the reasons:

1. The book value of the assets did not necessarily reflect the actual or market value.

2. According to Hammett, the removal of the $86,000 United Finance Corporation notes on October 18, 1957, could not have caused an impairment—such notes were not admitted assets and,

as a result thereof, United was already in a deficit condition on October 17, 1957. (R.T. 268, 272)

3. Hammett was not able to state the amount of impairment on October 17, 1957, as compared with the impairment on December 31, 1957. (R.T. 272)

In order to follow the Court's instructions, the jury was required to make a guess as to the value of the United assets transferred to American and then deduct therefrom the value of the 30,800 shares of American stock received in exchange. On the basis of the record, it would have been an utter impossibility for the jury to have arrived at a value of the American stock. As a result of the three-way transaction on October 18, 1957, American held approximately 38,000 shares of United stock, having a value of $7 per share, or $266,000. (R.T. 379) Furthermore, the American stock had a value based upon the management contracts which it owned. (R.T. 364) With this meager testimony, the jury was left groping in the dark as to the value of the American stock, but, needless to say, the jury was not justified in determining that the stock had no value whatsoever.

Plaintiff had the burden of proving the amount of damage which was sustained by United, if any, as a result of the transaction of October 18, 1957. It would have been relatively simple to have had some competent person make an appraisal of the assets transferred to American (and then to Kelly) and an appraisal of the 30,800 shares of American stock received by United. This was not done. Plaintiff elected to base his case upon pure conjecture. It is elementary that verdicts must have a more substantial basis than mere surmise, supposition, speculation, suspicion or conjecture. *U. S. Smelting etc. Co. v. Wallapai Mining Development Co.*, 27 Ariz. 126, 230 P. 1109; *Salt River Valley Water User's Association v. Blake.* 53 Ariz. 498, 90 P.2d 1004; *City of Tucson v. Apache Motors,* 74 Ariz. 98, 254 P.2d 255.

It is respectfully submitted that the verdict rendered in the lower Court has no support in the evidence and that the judgment of the lower Court must be reversed with instructions to enter judgment in favor of DePinto.

2. Errors in Admission of Evidence (Question No. 3. Specifications of Error Nos. 2 & 11.)

(a) FACTS AND CIRCUMSTANCES UNRELATED TO TRANSACTION OF OCTOBER 18, 1957

Over the strenuous objection of DePinto, the trial Court permitted plaintiff to introduce evidence of facts and circumstances, particularly the conduct of DePinto, having no relationship whatsoever to the transaction of October 18, 1957. For example: DePinto served as a member of the Board of Directors of Life Underwriter's, Inc. He was mentioned in a prospectus issued by that company for the sale of its stock to the public. (R.T. 181) DePinto attended a meeting of the United directors and shareholders on March 29, 1955. The meeting was called by Kelly to hear the complaints of one James Burke, to the effect that the company was not being administered properly. One Dr. Harry Cummings appeared at the meeting and complained about the management of United. (R.T. 186-187, 194-197; Ex. 4B) Minutes of a meeting of the Board of Directors of United held on November 15, 1955, indicated that DePinto attended said meeting when, as a matter of fact, he was not present. (R.T. 201-202) Minutes of a meeting of the Board of Directors of United held on February 19, 1957 state that DePinto was present, in person, when, as a matter of fact, he did not attend such meeting. (R.T. 203-204) DePinto did not attend a meeting of the Board of Directors of United held on June 22, 1956. (R.T. 205) DePinto thought that Kelly was president of United up to October 18, 1957. During his tenure as a member of the Board of Directors of United, DePinto did not make a telephone call to United's

office to obtain information concerning United's financial condition, did not call at United's offices and did not examine the report of the Director of Insurance prepared for United for the year ending June, 1956. It was DePinto's impression that United earned a profit for the year 1955, whereas it actually sustained a loss. DePinto did not know who were the officers of United from July 18, 1956 to October 18, 1957. DePinto never wrote a letter or sent a notice of any kind to the shareholders of United that he did not intend to actively participate as a director of United. (R.T. 208-209)

In view of the fact that the only issue in this case was the question of whether or not the transfer of assets from United to American on October 18, 1957 was proximately caused by negligence of DePinto in participating in the election of the Niesz group to the Board of Directors of United, it becomes obvious that the only purpose that could be served by all of the extraneous and immaterial evidence above-mentioned would be to prejudice DePinto in the eyes of the jury. DePinto's liability or non-liability for the transaction of October 18, 1957 does not in any way depend upon his acts or omissions as a member of the Board of Directors of United prior to October 18, 1957. In the case of *Consolidated National Bank v. Giroux,* 18 Ariz. 253, 158 P. 451, the Supreme Court of Arizona held that, in an action for breach of contract of sale in refusing to accept delivery of cattle, evidence that the defendant, with the consent of plaintiff, deducted $3,000 from the purchase price of a previous shipment under the same contract was inadmissible and prejudicial as creating an improper inference that the defendant wrongfully took advantage of plaintiff in another transaction not involved in the action. Among other things, the Supreme Court of Arizona stated:

> "How this transaction may have been played before the jury by counsel for appellees in their argument may be

easily imagined, and that it would tend to excite their prejudice is most certain."

In the case at Bar, the prejudicial effect of the above-mentioned testimony was aggravated by the trial Court's instructions to the jury. The jury was advised that failure of a director to attend director's meetings, failure to examine minutes and documents subject to a director's approval and failure to make reasonable inquiry as to important transactions of the corporation could be considered as negligence. (R.T. 578) In other words, the Court, in effect, permitted DePinto to be "convicted" by reason of the fact that he failed to attend directors' meetings, failed to examine minutes and documents and failed to inquire as to transactions of the corporation, even though such dereliction had nothing whatsoever to do with the transaction of October 18, 1957.

(b) EVIDENCE RE DAMAGES

The trial Court, over the objection of DePinto, allowed the introduction in evidence of page 61 of Exhibit 16, being a report of an examination of the affairs of United made by Guly L. Hammett, an examiner for the Insurance Department of the State of Arizona, during the year 1958. The report was inadmissible as being pure hearsay. The report was not admissible as an official document. In the case of *Olender v. United States*, 210 F.2d 795 (9 Cir. 1954) this Court stated:

> "Thus, this circuit and most of the other circuits which have passed on the question have held that the facts stated in the document must have been within the personal knowledge and observation of the recording official or his subordinates, and that reports based upon general investigations and upon information gleaned second-hand from random sources must be excluded."

Over the strenuous objection of DePinto, the trial Court permitted the introduction into evidence of Exhibit No. 83 (Kelly's

1957 federal income tax return), and former testimony of Mr. Kelly with respect to the preparation of the return by Mr. Frank Campbell. (R.T. 329-330) The income tax return is pure and unadulterated hearsay. Apparently, the income tax return was admitted upon the theory that it constituted proof of the reasonable value of the assets which were removed from United on October 18, 1957, and found their way into the hands of Kelly. Unfortunately DePinto had no opportunity to cross-examine with respect to the contents of said return. The Court will recall that the agreement between American Security Investment Company and Kelly of October 18, 1957 (Ex. 58), provided that, as consideration for his stock, Kelly would receive cash in the amount of $176,840.95, bonds of the value of $16,370.18, and "existing notes and mortgages *owed* by Kelly in the amount of $131,-925.35." The last item, necessarily, referred to the two first mortgage notes and the three notes of United Finance Corporation, which are listed in the minutes of the meetings of the boards of directors of United and American on October 18, 1957. (Exs. 5H & 50N) It is apparent that the mortgage notes and the notes of United Finance Corporation (which, in reality, were obligations of Kelly) would not have had the same value in the hands of a stranger as they would have in the hands of Kelly. Needless to say, DePinto was substantially prejudiced by the admission of such incompetent evidence.

Over the objection of DePinto, the witness Hammett was permitted to testify with respect to the financial condition of United on October 17, 1957, its condition on December 13, 1957, and to give an opinion as to the effect of the transfer of assets from United to American on October 18, 1957. All of such testimony was inadmissible for the reason that it was hearsay and not supported by a proper foundation. (R.T. 262-263)

3. Errors in the Rejection of Evidence (Question No. 4. Specifications of Error Nos. 3 & 11.)

(a) PLANS OF NIESZ GROUP; CONSULTATION WITH LAWYERS AND PUBLIC OFFICIALS

The Trial Court rejected the testimony of Kelly which disclosed:

Kelly's initial conversations with Niesz, Ballantyne and Croydon relative to the sale of his stock. The plans of the Niesz group with respect to the use of United funds for the purchase of stock accompanied by a plan to secure mortgages to be placed in either United or American to the end that the surplus of United would not be impaired. The approval of the plan by Earl Glenn of the law firm of Jennings, Strouss, Salmon & Trask. Consultations of Niesz, Tompane, Croydon and Heineman with the Insurance Division and Securities Division of the Corporation Commission of the State of Arizona. Discussion of the proposed plan at the office of Jennings, Strouss, Salmon & Trask on October 18, 1957, at which time there were present Croydon, Ballantyne, Niesz, Kelly, Bretz and Dunn, and attorneys Campbell, Salmon, Glenn, Heineman and Goss. Discussions of Kelly with the State Insurance Commissioner with respect to the proposed plan. Information received by Kelly that mortgages would be forthcoming through Mr. Tompane of Phoenix Title and Trust Company for the purpose of backing up American stock. (O.T. 442-555, R.T. 294-324).

The Trial Court rejected testimony of Croydon with respect to the following facts and circumstances:

The plans of the Niesz group as outlined in the telegram from Croydon to Landoe of October 14, 1957. The origin of the plan for the purchase of Kelly's stock in part with the assets of United. Croydon's valuation of the Kelly stock. Croydon's efforts to sell Kelly's stock to Insurance Corporation of America. Croydon's discussions with the Director of Insurance, George Bushnell. Croydon's discussions with Eugene Tompane relative to the ac-

quisition of mortgages. Croydon's statement that the notes of United Finance Company in the amount of $86,000.00 were not admitted assets. Croydon's understanding that at the time of the meeting on October 18, 1957, in the office of Jennings, Strouss, Salmon & Trask, he had a commitment from Eugene Tompane with respect to the mortgages. (O.T. 927-1025, R.T. 334-379).

The Trial Court excluded all of the testimony of the witness Eugene Tompane with respect to his conferences with Niesz, Croydon and Ballantyne and with Mr. Toll the Director of Securities of the Arizona Corporation Commission; his telephone conversation with Mr. Bushnell, the Director of Insurance, and his advice to Niesz and Ballantyne that he thought mortgages could be made available. (R.T. 397-408).

The Trial Court rejected all of the testimony of the witness Niesz which disclosed:

The efforts of the Niesz group to work out a plan for the purchase of the Kelly stock by American which would in all respects comply with the law and not result in any damage to United. The Niesz group were guided by competent attorneys and discussed the proposed plan for acquiring Kelly's stock with the Insurance Commissioner of the State of Arizona and the Director of the Securities Division of the Corporation Commission of the State of Arizona. Dr. Sabo invested $115,000.00 in American—$52,000.00 on October 18, 1957, $23,000.00 on October 28, 1957, and approximately $40,000.00 which was used to purchase the Statewide Benefit Insurance Company. (O.T. 600-738; R.T. 484-542).

The Trial Court rejected the testimony of Dr. Sabo which disclosed that he made an investment of $115,000.00 in American and that he and his associates had no intention to loot United of its liquid assets in order to pay Kelly for his stock. (O.T. 832-869; R.T. 356, 489-492).

The Trial Court excluded all of the testimony of the witness Gregory which disclosed:

After the merger of United with Provident Security Life Insurance Company the latter company secured, by means of Certificates of Contribution, mortgages having a value of over $200,000.00 which were then carried on the books of Provident as assets and part of its surplus. The forms of Certificates of Contribution are supplied by the office of the Insurance Director. (R.T. 527-537).

The Trial Court also excluded testimony of the witness Landoe disclosing that Dr. Sabo invested $115,000.00 in American. (R.T. 543).

The Trial Court rejected DePinto's offer to read into evidence "Admitted Facts" contained in the Pre-Trial Order and numbered 113 to 116, 121 to 160 and 171 to 189. (T.R. 103-112; R.T. 518-520). These "Admitted Facts" disclose:

Pegram's background as a Bozeman, Montana business man and associate of Dr. Sabo. Landoe's background as a Bozeman, Montana lawyer who had represented Dr. Sabo on numerous occasions. The conferences of Landoe and Pegram with Croydon, Ballantyne and Niesz in Phoenix about September 10, 1957 relative to the organization of a holding company to acquire and manage life insurance companies. Pegram and Landoe's discussions with attorney, Harry Goss and Eugene Tompane, of Phoenix Title and Trust Company with respect to the reputation, financial responsibility and experience of Croydon, Niesz and Ballantyne. The meeting of Landoe, Pegram and Sabo with Croydon, Niesz and Ballantyne on or about September 27, 1957, at which time it was agreed to form American with Harry Goss acting as the attorney. Dr. Sabo's agreement to invest $115,000.00 in American. Dr. Sabo's transmittal of $52,000.00 to American on October 18, 1957.

The "Admitted Facts" contained in the Pre-trial Order together with the proffered testimony of the witnesses hereinabove men-

tioned give a substantially complete picture of the activities of the Niesz group on and prior to October 18, 1957 with respect to the formation of American and its acquisition of the Kelly stock. If DePinto can be held liable in this action it can only be on the basis of the allegations of Count VII of Plaintiff's Complaint to the effect that he negligently transferred the control of United to the Niesz group "who thereafter proceeded to loot the defendant, United Security Life of its liquid reserves". The evidence which was excluded by the Trial Court discloses that the Niesz group did not loot United and had no intention of looting it. It discloses that each member of the Niesz group was acting pursuant to the advice of counsel, that the Director of Insurance and the Director of the Securities Division of the Corporation Commission had been consulted, that the group mistakenly, but in good faith thought that their plan could be implemented by mortgages furnished through Eugene Tompane pursuant to Certificates of Contribution which had approval of the Director of Insurance and that Dr. Sabo was making a very substantial investment in the program namely, $115,000.00. It is extremely significant that the plan for the obtaining of mortgages to augment the surplus of United was not an impractical scheme. When United was merged with Provident the latter company secured, by means of Certificates of Contribution, mortgages having a value of over $200,000.00 which were then carried on the books of Provident as assets and part of its surplus.

If Dr. DePinto—or a hypothetical prudent director—had made an investigation of the facts and circumstances surrounding the transaction of October 18, 1957 he would presumably have learned of the facts above-mentioned and which were withheld from the jury. How could the jury make a determination that DePinto's failure to investigate all of the details of Kelly's proposed sale of stock was or was not a proximate cause of loss to United without knowledge of all of the facts and circumstances

that any such investigation would have revealed? It was for the jury to make such judgment based upon a view of the complete picture. With the whole picture before it, the jury might well have concluded that a prudent director would not have refrained from participating in the election of the Niesz group to the Board of Directors of United. The bulk of the testimony which was excluded by the Trial Court was testimony adduced at the initial trial. After hearing all of such testimony the jury which sat at the first trial returned a verdict in favor of DePinto. That jury found specifically that DePinto was not "negligent as a director of United Security Life in one or more particulars proximately causing or contributing to loss or damage to said corporation with respect of transfer of the assets in question." (O.T. 305).

(b) REPUTATION OF NIESZ GROUP

The Trial Court consistently rejected testimony with respect to the reputation of various members of the Niesz group for integrity and business ability, including the testimony of witnesses Kelly, (R.T. 306) Johnson, (R.T. 467-469) Goss, (R.T. 477) and Gary (R.T. 522-524). It is the position of DePinto that if he participated in the election of reputable business and professional men to the Board of Directors of United he could not under any circumstances be held liable for their subsequent conduct. In any event, for the purpose of appraising DePinto's conduct and its relationship to the transaction of October 18, 1957, the jury was entitled to know just what DePinto would have learned had he made an investigation of the antecedents of the Niesz group. If the jury had received affirmative evidence of the fact that DePinto had not participated in the election to the Board of Directors of United of crooks, thieves or incompetents (persons who might be expected to "loot" United) they no doubt would have exonerated DePinto from any and all liability for the acts of the Niesz group.

(c) EVIDENCE AS TO DAMAGES

The transaction of October 18, 1957 did not cause any loss or damage to United except to the extent that the value of the assets transferred to American exceeded the value of the 30,800 shares of American stock which United received in return. (Note instruction of Trial Court. R.T. 587-588). Under the circumstances plaintiff was clearly entitled to introduce any evidence bearing upon the value of the American stock. This would include testimony with respect to the investment which had been made in American by the stockholders thereof and also testimony with respect to the value of United stock which was acquired by American from Kelly and United Family Guild.

The Trial Court, nevertheless, rejected "Admitted Fact" numbered 188 disclosing that Dr. Sabo transmitted $52,000.00 to American on October 18, 1957. The Trial Court excluded testimony of the witness Kelly bearing upon the value of United stock. (O.T. 498, 553-555; R.T. 316-317, 324). Testimony of the witness Croydon bearing upon the value of United stock was excluded. (O.T. 958-974, 1012-1013, 1023-1025; R.T. 355-362, 376, 379). The Trial Court rejected the testimony of the witnesses Sabo, Niesz and Landoe with respect to the $115,000.00 investment which was made in American by Sabo. (O.T. 736-738, 832, 856, 869, 1094-1095; R.T. 356, 489-492, 542-543). The trial Court excluded testimony of the witness Hammett bearing upon the value of United stock. (O.T. 1060-1063; R.T. 544). The testimony of Hammett which was excluded included the statements with respect to the value of the 38,000 shares of United stock acquired by American:

> "Q. In short, your valuation had nothing to do with the going price of this stock, did it?
>
> "A. Not the going price, no sir.
>
> "Q. It was simply a computed formula set forth in the Insurance Code?
>
> "A. Not even that."

4. Errors in Charge to Jury. (Question No. 5. Specifications of Error Nos. 4 & 11.)

The trial Court instructed the jury:

> "The particular acts or omissions on the part of the defendant DePinto, which plaintiffs allege occurred and amounted to negligence or breach of fiduciary duty are as follows: Acceptance of the office of director without intending to discharge the duties and responsibilities of director; delegating or relinquishing his responsibilities as a director to Kelly; failing to attend directors' meetings; failure to examine minutes, records and transactions and documents of the corporation; failure to keep himself advised by reasonable inquiry as to important transactions of the corporation." (R.T. 570)
>
> * * * * * * *
>
> "'* * * However, any of the following acts or omissions, if determined by the jury to have resulted from a failure to exercise reasonable care, may be found to constitute negligence and breach of fiduciary duty chargeable to a director, failure to attend directors' meetings, failure to examine minutes and transaction documents subject to a director's approval, failure to make reasonable inquiry as to important transactions of the corporation, and failure to act with respect of conditions and transactions potentially harmful to the corporation and its stockholders when such are brought to the director's attention, or of which he should have learned as a director exercising reasonable care.'" (R.T. 578)

DePinto objected to the foregoing instructions (R.T. 598-599), for the reason that the jury was thereby invited to find that DePinto was guilty of negligence with respect to acts or omissions which had nothing to do with the transaction of October 18, 1957. There was no evidence introduced to support the allegation of Count VI, that DePinto caused or permitted United to transfer certain of its assets to American. If there were any issue which the Court might properly (which we deny) have submitted to

the jury, it was the issue raised by the allegations of Count VII, to the effect that DePinto negligently transferred control of United to the Niesz group, who, thereafter, proceeded to loot United of its liquid reserves.

Contrary to the above-quoted instructions of the trial Court, plaintiff did not allege that the acts or omissions on the part of DePinto, amounting to negligence or breach of duty, were "acceptance of the office of director without intending to discharge the duties and responsibilities of director; delegating or relinquishing his responsibility as a director to Kelly; failure to attend directors' meetings; failure to examine minutes, records and transactions and documents, etc., etc." The instruction is a complete misstatement of plaintiff's claim, and obviously, DePinto was substantially prejudiced when the trial Court instructed the jury that it could find DePinto guilty of negligence in failing to attend directors' meetings, failure to examine minutes, etc. In the light of the evidence with respect to DePinto's conduct as a director of United, the Court's instruction was practically a command that the jury find him guilty of negligence. In this case, we are concerned with the conduct of DePinto in relation to the transaction of October 18, 1957. His only relationship with that transaction was his participation in the appointment of the Niesz group to the board of directors of United. Every act or omission of DePinto prior to that time had no bearing whatsoever upon the question of whether or not the transfer of assets from United to American was proximately caused or contributed to by DePinto's participation in the election of the Niesz group as members of the board of directors of United. If DePinto had been the most conscientious and persevering of corporate directors prior to October 17, 1957, such fact would have had no more relevancy to the transactions of October 18, 1957, than the fact that he was apparently something less than a model director prior to that date.

The Court further instructed the jury as follows:

"The law does not permit a director of a corporation to remain silent and inactive when he knows, or in the exercise of reasonable care by him, he should know, that an illegal transaction, or one potentially harmful to the corporation is being attempted by officers or other directors of the corporation.

* * * * * * *

"If by negligent acquiescence, a director permits corporate assets to be diverted or transferred to the loss of the corporation, such director is liable to the corporation for damages proximately resulting therefrom." (R.T. 579)

Defendant objected to this instruction (R.T. 599), for the reason that it has no application to the facts in this case. The instruction could only be applicable in a situation where a director is sought to be held liable for the acts of other directors which have taken place while he is a member of the board. It is fairly obvious that the instruction was prepared by plaintiff's counsel with the thought that it would be applicable to the defendant Duhame, who remained on the board of directors for some months following October 18, 1957. DePinto could not "acquiesce" in the acts of directors who succeeded him on the board of United. Furthermore, the instruction invites the jury to find that DePinto should not have remained "silent and inactive, when he knew or in the exercise of reasonable care should have known, that an illegal transaction was being attempted by officers or other directors of the corporation." The instruction is highly prejudicial to defendant for the reason that there is not a scintilla of evidence that he knew that the Niesz group intended to perpetrate an illegal transaction, nor is there any evidence whatsoever to support the conclusion that he was aware of any suspicious circumstances which would have required an investigation on his part. He knew that a group of business and professional men were purchasing Kelly's stock and that they were taking control of

United. These facts certainly did not point to the probability of skullduggery or chicanery.

The Supreme Court of Arizona has, on numerous occasions, held that it is reversible error for the trial Court to instruct the jury with respect to the law applicable to a state of facts, which is not supported by the evidence. *Butane Corp. v. Kirby,* 66 Ariz. 272, 187 P.2d 325; *Alires v. Southern Pacific Co.,* 93 Ariz. 97, 378 P.2d 913. To paraphrase the Supreme Court of Arizona, the mere submission of the instruction constituted a direction by the Court to the jury that there was a state of facts to which the instruction applied—facts from which negligence of DePinto (proximately causing damage to United) could be found as a matter of law. (378 P.2d 917)

The Court charged that "a director who delegates his duties to officers or employees of the corporation, or to other directors and negligently fails to take part in the management of the corporation, is liable for misconduct of those to whom he delegated his responsibilities. * * *" (R.T. 581) Defendant objected to the instruction (R.T. 600), for the reason that, here again, the instruction has no application whatsoever to the relevant facts in this case. Plaintiff is attempting to hold defendant liable for the acts of the Niesz group—the United directors who succeeded DePinto. DePinto did not make any delegation of his authority to the Niesz group. He participated in their election to the board of directors and resigned. The Niesz group secured their authority to act from United by reason of their being members of the board of directors, not by reason of any authority of DePinto (he then had none), which was delegated to them. Any juror listening to the charge would unquestionably conclude that the Court was instructing him that DePinto had delegated his authority as a director to the Niesz group and that DePinto was, therefore, responsible for the conduct of the Niesz group.

The Court instructed the jury that a director of a corporation may resign from office, but that a resignation specified therein to take effect upon acceptance does not become effective until it becomes accepted. Defendant objected to the instruction (R.T. 600), for the reason that the instruction assumes that there is some issue with respect to defendant's resignation. After listening to the instruction, the jury might well have concluded that defendant's resignation from the board of directors of United never became effective. The "Admitted Facts" contained in the Pretrial Order state (T.R. 100; R.T. 518), "at a meeting of United's Board of Directors on October 18, 1957, at about 4:15 P.M., defendant DePinto's resignation as a member of United's board of directors was accepted". Here, we have the Court instructing the jury as to the law applicable to a state of facts which is not only wholly unsupported by the evidence, but is flatly contrary to the evidence.

The Court gave the following instruction:

> "The fact that a director was not personally present at a particular directors' meeting at which a transaction later in controversy was approved will not in itself relieve the absent director from a director's responsibility for such transaction.
>
> "In this connection you are instructed:
>
> "1. The absent director received prior notice of the meeting as prescribed in the corporate bylaws and practice, or approved a waiver of such notice, he will be held responsible for corporate action taken at the meeting unless within a reasonable time after the meeting, he takes reasonably adequate steps to have his objection and dissent to such action specifically recorded in the minute records of the corporation.
>
> "2. If an absent director did not receive or waive notice of such meeting, but he actually knew, or by the exercise of reasonable care should have known, of corporate approval of a contested transaction, and thereafter the director failed to take reasonably prompt steps

> to protest the corporate action and record his objections and dissent thereto in the minute records of the corporation, the absent director would have a director's responsibility for the contested transaction even though he did not attend the meeting, or in the latter instance, waived notice thereof; that is, if he had known of the transactions being conducted at a purported meeting, a special meeting of directors of the corporation held without notice of the meeting as prescribed by corporate laws or waiver thereof by some directors is illegal, and corporate action taken at such meeting is invalid unless afterward ratified. Corporate action taken by some directors at such a meeting thereafter may be ratified by the absent directors at a later legal meeting, or by subsequent corporate transactions pursuant to action taken at the meeting, which is known to and approved by the absent directors.
>
> "While a resolution at a special directors' meeting at which some directors did not have timely notices is invalid, if a director does not object to such resolution or action taken pursuant thereto within a reasonable time after he has, or in the exercise of reasonable care should have, acquired knowledge of corporate action taken pursuant to such resolution, the director's failure to object to such corporate action may be found to be ratification of such director of the resolution taken at the meeting otherwise invalid as to him." (R.T. 583-584)

DePinto objected to this instruction (R.T. 601) for the reason that we, again, have the Court instructing the jury as to the law applicable to a state of facts involving the defendant Duhame, but in no way involving the defendant DePinto. The jury could not have construed the instruction to have application to a meeting of the board of directors of United other than the meeting held at 4:15 P.M. on October 18, 1957, at which the first order of business was acceptance of the resignation of DePinto. (Ex. 5H) The only corporate action which was taken at a directors' meeting of United and for which it is attempted to hold DePinto

liable was the aforesaid meeting at 4:15 P.M. on October 18, 1957. The instruction is applicable to an "absent director". DePinto was absent from the meeting, but he was not a director. He was not in a position to object to any action taken at that meeting, nor was he in a position to ratify the action taken at that meeting.

The instruction could have meant just this to the jury—DePinto was a director at the time of the meeting, he was absent from the meeting, he did not object to, or protest, the action taken at the meeting, he ratified the action taken at the meeting, he is legally responsible for all action taken at the meeting.

5. Errors in Failing to Charge Jury as Requested. (Question No. 6. Specifications of Error Nos. 5 & 11.)

The trial Court refused to give DePinto's Requested Instruction No. 4 (T.R. 82) to the effect that, even though DePinto might be deemed negligent in not making an investigation of the backgrounds and reputations of the Niesz group, the jury should, nevertheless, render a verdict for DePinto, unless it further found that the backgrounds and reputations of such men would justify the conclusion that, in all likelihood, they would conduct the affairs of United in a wrongful, irregular or negligent manner. This instruction would have placed squarely before the jury the question of proximate cause as announced in *Restatement of the Law*, Torts 2d, ¶ 448, and also in *Salt River Valley Water Users' Association v. Cornum*, 49 Ariz. 1, 63 P.2d 639. DePinto was entitled to have the jury informed of the legal principals, which, as applied to the facts in this case, would require the jury to conclude that the acts of the Niesz group in transferring assets from United to American was a superseding cause of harm to United which relieved DePinto of any responsibility therefor. The prejudice to DePinto from the failure of the trial Court to give the charge requested is obvious.

The trial Court failed to give that portion of DePinto's Requested Instruction No. 5, reading:

> "And the burden is upon the plaintiff of proving that the performance of the defendant DePinto's duties as a director of United Security Life would have avoided loss and what loss it would have avoided. In order to be entitled to a verdict at your hands the defendant DePinto is not subject to the burden of proving that loss, if any, to United Security Life could have happened whether he had done his duty or not."

This is a rescript of language used by Judge Learned Hand in the case of *Barnes v. Andrews,* 298, F. 614 (D.C.S.D.N.Y. 1924). It is clearly a statement of the law which is applicable to the evidence in this case. Defendant was entitled to have the jury so instructed.

In instructing with respect to proximate cause, the trial Court failed to give portions of DePinto's Requested Instruction No. 8, particularly:

> "If the negligence does nothing more than furnish a condition by which the loss is made possible, and that condition causes a loss by the subsequent independent actions of third persons, the two are not concurrent and the existence of the condition is not the proximate cause of the injury. * * * If the acts of third persons, which is the immediate cause of loss, such as in the exercise of reasonable diligence would not be anticipated, and the third persons are not under the control of the one guilty of the first act or omission, the connection is broken and the first act or omission is not the proximate cause of the loss."

Defendant's Requested Instruction No. 8 was taken almost verbatim from *Salt River Valley Water Users' Ass'n. v. Cornum,* 49 Ariz. 1, 63 P.2d 639 (Ariz. 1936). Its applicability to the case at Bar is demonstrated by the fact that DePinto was charged with creating a condition which made it possible for the Niesz group to carry out their plan of transferring certain of United's assets

to American. Proximate cause is not a matter that is clearly and completely understood by all lawyers and judges, much less laymen sitting on a jury. When the matter of proximate cause is explained to a jury, the party defendant is certainly entitled to have the matter explained to the jury as fully, completely and clearly as possible. There was no reasonable justification for the Court to withhold from the jury portions of DePinto's Requested Instruction No. 8, which is, obviously, the law in the State of Arizona.

6. Errors with Respect to Deliberations of Jury. (Question No. 7. Specifications of Error Nos. 6 & 11.)

The minute entries of the trial Court disclose that the jury retired to consider its verdict at 1:47 P.M. on June 16, 1965. A verdict was returned at 11:55 P.M. on that date. (T.R. 292-293) The minutes of June 16 also disclose:

> "At 12:02 A.M. the jury is discharged from the further consideration of this case and excused subject to call. It is ordered that the communications from the jury and responses, marked No. 1 and No. 2, be filed by the Clerk and that the record show the responses were taken up with counsel and are proper; and that communication from the jury marked No. 3 be filed." (T.R. 236)

At about 6:00 P.M., the jury sent the following communication to the trial Judge:

> "1. Jury wishes a repeat of the 3 factors to be used in judging for the plaintiff.
>
> "2. The verdict lists the defendants as:
>
> Provident Life Ins. Co.,
>
> Angus J. DePinto, et al,
>
> "Our impression from the trial is that Dr. DePinto was the only defendant. Please clarify." (T.R. 237)

The reply of the trial Judge appears as follows:

> "Answering your First inquiry:

The three (3) ultimate issues are:

1) Was defendant DePinto negligent in performing his fiduciary duties in one or more of the particulars asserted by plaintiffs?

If so,

2) Did such negligence of defendant DePinto proximately cause or contribute to causing loss or damage to United Security Life?

If so,

3) What was the amount of such loss or damage?

"The three items of claimed damage are:

1) Cash, by check or bank certificates of deposit—	$166,498.66
2) Promissory notes and accrued interest thereon—	87,626.88
3) Mortgages, bonds and accrued interest thereon—	60,668.65
Total	$314,794.19

"Answering your Second inquiry:

There are other defendants in the case, but the present trial is concerned only with the liability of defendant DePinto."

(T.R. 238)

We submit that it was an egregious error on the part of the trial Judge to advise the jury with respect to "the three items of claimed damage", and then to total such items in the amount of $314,794.19. Nowhere in the evidence is there any reference to "the three items of claimed damage". The jury did not seek information with respect to the items of claimed damage. They asked for a "repeat of the three factors to be used in judging for the plaintiff." The most prejudicial thing about the trial Court's note to the jury was the fact that it practically invited them to render a judgment against DePinto in the amount placed before

them in black and white—$314,794.19—and to completely ignore the instructions of the Court that:

> "If your computation of damages, the value, if any, you find of the American Security Investment Company stock received by United Security Life, as disclosed by the evidence, should be deducted from your findings as to the amount of the value of the assets transferred to Kelly."

(R.T. 588)

The applicable rule with respect to the trial Court's communications to the jury after it has retired to consider its verdict is found in the case of *Fillippon v. Albion Vein Slate Co.*, 250 U.S. 76, 63 L.Ed. 853, 39 S.Ct. 435, wherein the Supreme Court of the United States said:

> "We entertain no doubt that the orderly conduct of a trial by jury, essential to the proper protection of the right to be heard, entitles the parties who attend for the purpose to be present in person or by counsel at all proceedings from the time the jury is impaneled until it is discharged after rendering the verdict. Where a jury has retired to consider of their verdict, and supplementary instructions are required, either because asked for by the jury or for other reasons, they ought to be given either in the presence of counsel or after notice and an opportunity to be present; and written instructions ought not to be sent to the jury without notice to counsel and an opportunity to object. Under ordinary circumstances, and wherever practicable, the jury ought to be recalled to the court room, where counsel are entitled to anticipate, and bound to presume, in the absence of notice to the contrary, that all procedings in the trial will be had.

We do not deny that the Court's responses to the jury's questions were "taken up with counsel". Unfortunately, the record does not disclose the scope of that communication. But, whether or not there was a lack of communication between the trial Court and the attorneys for DePinto is beside the point. The funda-

mental question is whether or not a party litigant is to be saddled with a judgment in excess of $300,000, which was based upon the verdict of a jury which, quite probably, would not have been rendered in the absence of an erroneous communication from the trial Court. In the case of *Michie v. Calhoun*, 85 Ariz. 270, 336 P.2d 370, the Supreme Court of the State of Arizona took cognizance of erroneous instructions given to the jury by the trial Court notwithstanding the absence of a proper objection. We respectfully submit that the record in this case discloses that DePinto was deprived of the fair and impartial consideration of the jury based upon a clear understanding of the damages (if any) sustained by United, namely the value of the assets transferred from United to American, *less the value of the American stock received by United.*

7. Judgment Excessive. (Question No. 8. Specifications of Error Nos. 7 & 11.)

(a) CANCELLATION OF STOCK

Under the terms of the merger agreement entered into between United and Provident, on or about February 7, 1959, it was provided that any recovery in this action would be shared by each former owner of United stock in the proportion that the number of shares held by him bore to the total shares issued and outstanding. This was spelled out in the "Certificates of Contingent Interest" issued pursuant to the merger agreement. (Ex. G)

Pursuant to the merger agreement, the 38,798 shares of United stock held by American were cancelled and all rights therein were relinquished and released. (T.R. 132) Pursuant to the settlement made with the Duhame Estate, which was made with the approval of the trial Court, the Duhame Estate released and surrendered the right to participate in any recovery herein to the extent of 3,750 shares of stock. (T.R. 267) By reason of the

fact that 100,000 shares of United stock were originally outstanding and the fact that the American shares and the Duhame shares aggregating 42,548 shares have been cancelled, it is clear that the former holders of United stock who will share in any recovery herein, represent ownership of only a fraction (57,452/100,000) of United stock originally issued and outstanding. The right of Provident to secure a judgment on behalf of the former United stockholders who will share therein is therefore limited to 57½% of the total claim, namely $180,856.

The surrender of stock can be viewed in two perspectives. First, it eliminated from the group of stockholders who might be deemed injured by the acts of defendants, the owners of 42½% of United stock. Secondly, such surrender of stock constituted restitution by certain of the alleged wrong-doers (American and Duhame), equal to the value of such stock. The value of such stock would be not less than an amount equal to that portion of the judgment herein which 42,548 shares bear to the total shares of United stock which were outstanding at the time of the merger. This amounts to approximately 42½%. Looking at the stock surrender from either perspective, it is clear that it would be grossly inequitable and unjust to demand a 100% indemnity from DePinto for the benefit of the holders of 57½% of United stock. For the purpose of argument, let us assume that American had acquired all but one share of United stock and had surrendered the same for cancellation. Under the circumstances, no one would reasonably contend that United (or its successor, Provident), would be entitled to recover from American and the other defendants the amount of United's assets diverted by American for the purpose of then paying such amount over to the holder of the one share of stock remaining outstanding.

In the case of *Perlman v. Feldmann*, (CCA 2), 219 F.2d 173, 50 A.L.R.2d 1134, cert. den. 349 U.S. 952, 75 S.Ct. 880, 99 L.Ed. 1277, the Court of Appeals stated:

"Hence to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable to the minority stockholders who sue here. Restatement, Restitution §§ 190, 197 (1937); Seagrave Corp. v. Mount, supra, 6 Cir, 212 F.2d 389. And plaintiffs, as they contend, are entitled to a recovery in their own right, instead of in right of the corporation (as in the usual derivative actions), since neither Wilport nor their successors in interest should share in any judgment which may be rendered. See Southern Pacific Co. v. Bogert, 250 US 483, 39 S Ct 533, 63 L Ed 1099. Defendants cannot well object to this form of recovery, since the only alternative, recovery for the corportation as a whole, would subject them to a greater total liability." (50 A.L.R. 2d 1143)

In the *Perlman* case, Wilport participated in the wrongdoing just as American and Duhame participated in the wrongdoing in the case at bar. If American and the Duhames still held the 42,548 shares of United stock, it is clear that, in the light of *Perlman,* American and the Duhames would not be permitted to share in any judgment which might be rendered against DePinto. By reason of the Merger Agreement, this action is for the exclusive benefit of the holders of Certificates of Contingent Interest—former United stockholders, excluding American and Duhame. Provident is, in effect, acting as a trustee for such former stockholders. The recovery on behalf of the holders of Certificates of Contingent Interest can be no greater than the percentage of United stock which they held.

The rule is clearly stated in *Matthews v. Headley Chocolate Co.,* 130 Md. 523, 100 A. 645, 651:

"* * * Inasmuch as by the change of the majority of stock those who were minority stockholders at the time of the transactions complained of are now able to have the suit brought in the name of the company, we are of the opinion that it can be maintained, in that name instead of in the names of the minority stockholders but for their benefit.

But while that is so, if there be any recovery by reason of the claims spoken of, *it can only be to the extent of the proportions of the sum recovered due such minority stockholders,* if any, as are not barred by laches, limitations, acquiescence, or other way sufficient to bar them in equity, and anything recovered should be directed to be paid to them by the corporation." (Emphasis supplied.)

The Supreme Court of Washington has this to say in *Joyce v. Congdon,* 114 Wash. 239, 195 P. 29, 30:

"The plaintiff complains of the fact that the recovery in this case was to him individually, and not to the corporation. It is true that the general rule is that in actions of this character the amount of the recovery will go to the corporation, and not to the individual minority stockholders. This rule, however, is not universal. If in awarding a recovery to a corporation it would result in a stockholder's receiving a portion thereof, to which he was not entitled, then a court of equity will look beyond the corporation, and decree the recovery to the individual stockholders entitled thereto. Brown v. De Young, 167 Ill. 549, 47 N.E. 863."

There are numerous cases in accord, including:

Samia v. Central Oil Company of Worcester, 339 Mass. 101, 158 N.E.2d 469, 482;
Bailey v. Jacobs, 325 Pa. 187, 189 A. 320, 330;
Holland v. Presley, 6 N.Y.S.2d 743, 744;
Chounis v. Laing, 125 W.Va. 275, 23 S.E.2d 638;
Stanton v. Schenck, (S.Ct.N.Y. 1931) 251 N.Y.S. 221.

In the light of the above-mentioned authorities, it is clear that Provident, acting on behalf of only 57½% of the original stockholders of United, can recover from the defendant DePinto only 57½% of the amount of the alleged loss to United attributable to the acts of DePinto and his co-defendants, including American Security Investment Company and Duhame.

(b) CREDIT FOR PAYMENT BY "JOINT TORTFEASOR"

On July 12, 1965, the trial Court entered an order approving a settlement with the Executors of the Duhame Estate, calling for a payment by them of the sum of $100,000. Paragraph 3 of the order reads as follows:

> "The entire amount of the said settlement, being the sum of One Hundred Thousand Dollars ($100,000.00) plus the present value of the Certificates of Contingent interest surrendered by the Duhames for cancellation is allocated to the claims for damages to United Security Life arising during the period beginning June 30, 1956 and ending October 17, 1957, in the amount of $177,863.84." (T.R. 268)

In the lower Court, DePinto insisted that, as a result of the Duhame settlement, he was entitled to a credit of $100,000, upon the alleged claim of Provident against him. (R.T. 151-152; T.R. 241)

It is the settled law in Arizona that a payment made by one joint tortfeasor must be credited upon the claim made against another joint tortfeasor. *Fagerberg v. Phoenix Flour Mill Co.,* 50 Ariz. 227, 71 P.2d 222; *Igurrola v. Szychowski,* 95 Ariz. 194, 388 P.2d 242. The *Fagerberg* case is directly in point in that it involved an action brought by a corporation against one of its directors, alleging loss of $110,180.57, as a result of the joint negligence or wrongful acts of three directors. One of the directors (Melczer) paid to plaintiff the sum of $55,090.28, and took a covenant not to sue. The Court held that the defendant director was entitled to the credit for such amount. The losses to the corporation resulted from speculation in the stock market by Melczer and Fagerberg over a period from September, 1930 to April 1932. Although there may have been several losses to the corporation, the Court considered that there was but one joint claim against the three directors. In the *Igurrola* case, the Court held that payment made by one joint tortfeasor in consideration of a covenant not to

sue must be credited upon the claim against the other joint tortfeasor.

The action of the trial Judge in "allocating" the $100,000 Duhame payment to the "claims for damages to United Security Life arising during the period beginning June 30, 1956 and ending October 17, 1957 in the amount of $177,863.84" was meaningless. At the time of the Duhame settlement, the only claim against the Duhame Executors was the same claim made against DePinto, namely a claim for $314,794.19, resulting from the transfer of United assets to American on October 18, 1957 and set forth in the Amended Complaints of Doig and Provident. (T.R. 26, 44)

The claims referred to by the trial Court in the amount of $177,863.84,* arising during the period beginning June 30, 1956 and ending October 17, 1957, were claims made in the original Gorsuch complaint (T.R. 1) and which were dropped from the Complaints filed by Doig and Provident. (T.R. 24, 44) These claims were dropped from the later Complaints for the reason that by the original judgment entered in this cause, said claims were dismissed on the merits and with prejudice. (O.T. 354)

At the time of the Duhame settlement, there existed but one claim for which DePinto and the Duhame Executors might have been held liable, namely a claim for $314,794.19, arising out of a transaction which took place on October 18, 1957. If there were any other "claims" in the original Gorsuch Complaint, which survived the first Judgment in this cause, they were not reviewed by Doig or Provident after the first reversal. Under the decision of this Court in *Niesz v. Gorsuch*, 295 F.2d 909, it is clear that the original Gorsuch complaint must be treated as non-existent. By the merger, Gorsuch lost his right to maintain the action.

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*The claims were actually $132,839.51; $46,839.51 alleged to have been wrongfully paid to Kelly and $86,000 alleged to have been wrongfully loaned by United to United Finance Corporation. (O.T. 246)

Under the opinion of this Court, the action could only be revived if Provident was joined or caused to be joined within a reasonable time, after remand. The action survived only to the extent that it was revived within a reasonable time. It was not revived at all with respect to any claim or claims exceeding $314,794.19. Furthermore, the statute of limitations has long since run upon any claim exceeding that amount. A.R.S. § 12-542 or § 12-550.

If DePinto is given the $100,000 credit to which he is entitled, it follows that any judgment against him herein in an amount exceeding $80,856 cannot be sustained.

(c) INTEREST

Notwithstanding DePinto's objection (T.R. 242), the trial Court included in the judgment against DePinto interest at the rate of 6% per annum from October 18, 1957 until payment. The imposition of interest from any date earlier than the date of judgment is erroneous.

The claim made herein against DePinto was for damages alleged to have been proximately caused by the negligence of DePinto and his fellow defendants. The claim was based upon the transfer of assets from United to American. Such assets consisted of $166,498.66 in cash or certificates of deposit, $60,668.65 in mortgages, bonds and accrued interest, and $87,626.88 in unsecured notes and accrued interest. The value of such assets—excluding cash and bank certificates of deposit—was, of course, subject to speculation and conjecture. Furthermore, United received 30,800 shares of the common stock of American in exchange for such assets. The loss sustained by United as the result of the transaction of October 18, 1957 could not be more than the value of its assets transferred to American less the value of the 30,800 shares of American stock received by it. Until the determination by a Court or jury of the amount of damage to United, DePinto had no way of determining with any degree of

certainty, the amount of damage for which he might be held liable.

In the case of *Schwartz v. Schwerin*, 85 Ariz. 242, 336 P.2d 144, the Supreme Court of Arizona expressly overruled contrary decisions and held that "on an unliquidated claim interest should only be allowed from date of judgment." The Supreme Court quoted the following language from *Arizona Eastern R. Co. v. Head*, 26 Ariz. 259, 224 P. 1057, 1059:

> " '* * * If the claim is unliquidated and is in dispute no interest is allowed upon the theory that the person liable does not know the sum he owes and therefore can be in no default for not paying.' "

The ability of anyone to make some sort of an estimate as to the amount of loss or damages is not sufficient to create a liquidated claim. The case of *American Eagle Fire Ins. Co. v. Vandenberg*, 76 Ariz. 1, 257 P.2d 856, involved the claims of farmers against their insurance carrier for hail damage to their cotton crops. After inspecting the crops the insurance adjuster denied that there was a loss and damage by hail equal to 5% or more of the particular crops so damaged as the policy required before the insurance company would become liable thereon. The farmers instituted an action against the insurance company and recovered judgments totalling $2,240. Upon appeal the farmers claimed that they should have been allowed interest from the time the insurance proceeds became payable. The Supreme Court of Arizona held:

> "However, this was an unliquidated claim, and the extent of loss was not known until determined by the trial court. We hold the trial court properly allowed interest from the date of the judgment." (257 P.2d 859)

On the basis of the Arizona decisions above noted, it is submitted that the judgment entered herein cannot legally bear interest from a date earlier than the date of entry of judgment.

(d) DISCHARGE OF JOINT TORTFEASORS

By a stipulation entered into between the original plaintiff Gorsuch and the defendants James E. Kelly, L. N. Kelly, Nina Dunn and J. L. Jenkins, which stipulation was approved by order of the trial court, it was agreed that any judgment entered against any of said defendants herein would not exceed the sum of $308,000. (T.R. 24) As a result of such stipulation, the original judgment entered herein against said defendants was limited to $308,000. (O.T. 354) The stipulation and the judgment entered pursuant thereto had the effect of releasing and discharging the Kellys, Dunn and Jenkins of all liability in excess of $308,000. It is the law in Arizona that the release of one joint tortfeasor constitutes a release of all. *Fagerberg v. Phoenix Flour Mills Co.,* 50 Ariz. 227, 71 P.2d 1022; *Smith v. Pinner,* 68 Ariz. 115, 201 P.2d 741.

Aside from the rules applicable to a release, it is the law that, in an action against joint tortfeasors, judgment cannot be entered against any one defendant for an amount exceeding that entered against a co-defendant. 49 *C.J.S.* 88 § 36. *Brown v. Reorganization Investment Company,* 350 Mo. 407, 166 S.W. 2d 476; *Schwehr v. Badalamenti* (Ill.), 143 N.E. 2d 558; *Phipps v. Superior Court* (Cal.), 89 P.2d 698; *Donegan v. Beasley* (Tenn.), 181 S.W. 2d 379; *Callihan v. White* (Tex.), 139 S.W. 2d 129.

As a result of the stipulation above-mentioned and the judgment entered pursuant thereto against Kelly, et al., in the amount of $308,000, DePinto was automatically released from all liability in excess of that amount. When DePinto is given a proper credit for the amount of the American and Duhame stock which was cancelled (42½% of $308,000), namely $130,900, plus the $100,000 payment made by the Duhame Executors, we find that any judgment against DePinto of more than $77,100 is excessive and cannot be sustained.

8. Error in Severing Claim. (Question No. 9. Specifications of Error Nos. 8 & 11.)

On the morning set for trial of this action as to Defendants DePinto, Sabo, Pegram, Landoe and the Duhame Executors, the Court approved the Duhame settlement, severed the case as to DePinto and ordered consolidation of the case (Civil 2974-Phoenix) with Cause No. Civil 3062-Phoenix, as to the defendants Sabo, Pegram and Landoe. (T.R. 292; R.T. 171) The severance was made over the objection of DePinto. (R.T. 166, 169)

We submit that, if DePinto can be held liable for damages to United resulting from the transaction of October 18, 1957, it can only be on the theory that he is vicariously liable for the conduct of Sabo, Pegram, Landoe, Niesz, et al., in causing assets to be transferred from United to American. DePinto's liability (if any) is secondary and he can, therefore, look to Sabo, Pegram, Landoe, et al., for indemnity under his cross-claim. *Busybee Buffet v. Ferrell,* 82 Ariz. 192, 310 P.2d 817 (1957). The ruling of the trial Court deprived DePinto of his right to proceed against Sabo, Pegram and Landoe upon his cross-claim against them.

As a result of the trial Court's action, the attorneys for plaintiff presented evidence to the jury only in the form of documents, "admitted facts" and testimony adduced at the initial trial. DePinto was deprived of the opportunity to cross-examine Sabo, Pegram and Landoe.

We respectfully submit that the trial Court's action was not authorized under the provisions of Rule 21 of the Federal Rules of Civil Procedure, which reads:

> "Misjoinder of parties is not ground for dismissal of an action. Parties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just. Any claim against a party may be severed and proceeded with separately."

As pointed out by Professor Moore (3 *Moore's Federal Practice* 2910 ¶ 21.05), Rule 21 should be construed to authorize a severance only where there has been a misjoinder of parties. There was no misjoinder in this case.

Aside from the proper interpretation of Rule 21, it is obvious that the action of the trial Court was highly prejudicial to DePinto and constituted an abuse of any discretion which the trial Court might have had. Although DePinto's connection with the transaction of October 18, 1957 was remote compared with that of Sabo, Pegram and Landoe, he was placed in the position of a "target" defendant for the jury to shoot at. If the jury felt that plaintiff was entitled to some relief as a result of the October 18, 1957 transaction, its power to grant some relief could only be directed against DePinto. Conclusive evidence of the prejudice to DePinto is found in the verdict rendered in his favor at the initial trial—a trial which involved all of the parties who were in any way connected with the transaction of October 18, 1957.

9. Denial of Fair Trial. (Question No. 10. Specifications of Error Nos. 9 & 11.)

After reversal of the second judgment herein, DePinto, upon motion for rehearing, requested that this Court order a retrial of the action before a District Judge other than The Honorable George H. Boldt. The request was not granted. Thereafter, and on the 20th day of November, 1964, DePinto filed in the lower Court an Affidavit of Bias or Prejudice pursuant to 28 *U.S.C.A.* § 144. (T.R. 64) After a hearing, on December 2, 1964, before Judge Carl A. Muecke, an order was entered striking the Affidavit. Judge Boldt then concurred in the order of Judge Muecke, striking the Affidavit. (T.R. 287)

For the convenience of the Court, we have reproduced the Affidavit in full in Appendix E to this Brief. We respectfully submit that the Affidavit fully supports the conclusion stated in

the Affidavit, "That Judge Boldt is not able to consider the issues involved in this action with an open mind. The record demonstrates the inability of Judge Boldt to view the affairs of United Security Life with that degree of judicial detachment and objectivity which should govern all actions of a trial Judge."

We submit that the conduct of Judge Boldt subsequent to November 20, 1964 confirms the Affidavit. It cannot be doubted that a jurist of the intellectual caliber of Judge Boldt could not have committed error after error in the trial of this cause unless he found it impossible to view the case dispassionately and objectively. We do not, for one minute, challenge the bona fides of Judge Boldt. Unfortunately, however, and at some time during the many, many months that this action has been pending, Judge Boldt subconsciously assumed the role of an advocate, rather than that of a judge.

During the pretrial proceedings incident to the last trial, Judge Boldt took a very sympathetic view towards the contentions of plaintiff's attorneys that the claim against DePinto, et al., was not limited to the sum of $314,794.19, as prayed for in the Doig Complaint (T.R. 26) and the Provident Complaint (T.R. 44). Plaintiff's attorneys insisted that they were entitled to claim $177,863.84, on account of matters occurring between June 30, 1956 and October 18, 1957, and the sum of $60,695.60, on account of matters occurring subsequent to October 18, 1957. (T.R. 159-160; R.T. 62-120, 154) One of plaintiff's attorneys stated:

> "So we have claims, as I say, well over $800,000, closer to $825,000." (R.T. 154)

Judge Boldt ruled that plaintiff was entitled to proceed upon any claim that had ever been made in the case, notwithstanding, that claims in excess of $314,794.19, had been dismissed in the original judgment and dropped from the Amended Complaints.

(R.T. 85, 120, 156) Plaintiff's contentions were carried into the Pretrial Order (T.R. 159-160), which included the statement:

> "The Court orders that as a result of this pretrial order the pleadings pass out of the case * * *"

When counsel for DePinto refused to approve the Order because it destroyed their position that plaintiff's claim was limited to the pleadings (R.T. 122-123), Judge Boldt indulged in the following intemperate and unwarranted remarks:

> "In my mind, this is one of the most disgraceful incidents that I have seen in my entire period of practice, and especially in the period that I have been on the bench. It is a discredit to each one of you that any such thing as this should arise and occur. In my opinion, you have misled me into believing that you were at the very last stage of agreeing upon a pretrial order that would be approved for entry. Not the slightest mention has been made otherwise until this moment, and in my opinion, this is unworthy of reputable counsel, and I find it difficult to be restrained in my comments about it.
>
> "I thought I was trying to be as courteous and decent and friendly and considerate to you people as I possibly could be, and you have treated me with disrespect and discourtesy, and I resent it tremendously." (R.T. 126-127)

That Judge Boldt later apologized for his remarks (R.T. 144) is beside the point.

If there is any one thing in the record which alone demonstrates the inability of Judge Boldt to be fair to DePinto, it is the ruling which he made depriving DePinto of a credit on account of the $100,000 Duhame settlement, immediately followed by the severance ruling which left DePinto as the only person upon whom the jury could impose liability, should it believe that Provident, as the successor of United, was entitled to damages by reason of the conduct of the Niesz group on October 18, 1957. (R.T. 151-171; T.R. 206)

DePinto's Affidavit of Bias and Prejudice was filed pursuant to 28 *U.S.C.A.* § 144, reading, in part, as follows:

> "Whenever a party to any proceeding in a district court makes and files a timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to hear such proceeding."

In the case of *Berger v. United States,* 255 U.S. 22, 65 L.Ed. 481, 41 S. Ct. 230, the Supreme Court of the United States stated with respect to the above-quoted statute:

> "Nor is it our function to approve or disapprove it; but we may say that its solicitude is that the tribunals of the country shall not only be impartial in the controversies submitted to them, but shall give assurance that they are impartial,—free, to use the words of the section, from any 'bias or prejudice' that might disturb the normal course of impartial judgment. And to accomplish this end the section withdraws from the presiding judge a decision upon the truth of the matters alleged. Its explicit declaration is that upon the making and filing of the affidavit, the judge against whom it is directed 'shall proceed no further therein, but another judge shall be designated in the manner prescribed in § 23 to hear such matter.' "

In the case of *Re Murchison,* 249 U.S. 133, 99 L.Ed. 942, 75 S. Ct. 623, the Supreme Court of the United States said:

> "A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness."

In *Mitchell v. United States,* 126 F.2d 550 (10 Cir. 1942), the Court said:

> "The purpose of this section is to secure for all litigants a fair and impartial trial before a tribunal completely divested

of any personal bias or prejudice, either for or against any party to the proceedings, and it is the duty of all courts to scrupulously adhere to this admonition and to guard against any appearance of personal bias or prejudice which might generate in the minds of litigants a well-grounded belief that the presiding judge is for any reason personally biased or prejudiced against their cause."

The order of Judge Muecke striking the Affidavit of Bias or Prejudice (which order was joined in by Judge Boldt), states that the Motion to Strike was granted, "for the reasons that the said affidavit is not sufficient in that the affidavit fails to show facts or reasons to indicate personal bias or prejudice on the part of The Honorable George H. Boldt against the defendant, Angus J. DePinto, and for the further reason that the affidavit is not timely * * *"

Although there are numerous decisions to the effect that an Affidavit of Bias or Prejudice must be based upon something other than rulings against a litigant, in the case of *Whitaker v. McLean,* 118 F.2d 596 (USCA D.C. 1941), the Court stated:

"The policy underlying Section 21 is that the courts of the United States 'shall not only be impartial in the controversies submitted to them but shall give assurance that they are impartial'; i.e., shall appear to be impartial. Berger v. United States, 255 U.S. 22, 36, 41 S.Ct. 230, 234, 65 L.Ed. 481. A bias which develops during the trial and is 'grounded on the evidence' has been held not to be within the terms of Section 21. Craven v. United States, 1 Cir., 22 F.2d 605, certiorari denied 276 U.S. 627, 48 S.Ct. 321, 72 L.Ed. 739. Often some degree of bias develops inevitably during a trial. Judges cannot be forbidden to feel sympathy or aversion for one party or the other. Mild expressions of feeling are as hard to avoid as the feeling itself. *But a right to be tried by a judge who is reasonably free from bias is a part of the fundamental right to a fair trial. If, before a case is over, a judge's bias appears to have become overpowering, we think*

it disqualifies him. It follows that the judgment must be reversed." (Emphasis supplied.)

We submit that, under the provisions of 28 *U.S.C.A.* § 144, the filing of the Affidavit of Bias or Prejudice deprived Judge Boldt of all right, power or authority to take any further action in the case. So far as DePinto is concerned, it is immaterial why such bias developed or how it is demonstrated. He was entitled to a trial before an impartial judge and, as confirmed by subsequent events, this he did not receive. We suggest that this Court should be no less sensitive to the rights of DePinto than was the Tenth Circuit Court of Appeals with respect to the rights of the United States, as disclosed by the case of *United States v. Ritter*, 273 F.2d 30 (10 Cir. 1959). That action was instituted by a Navajo indian under the Federal Court Claims Act for the purpose of recovering damages for the unlawful seizure and destruction of 115 horses and 35 burros belonging to the plaintiffs. The trial Judge entered judgment for the plaintiffs in the sum of $100,000. The judgment was reversed by the Tenth Circuit (*United States v. Hatahley*, 220 F.2d 666); however this decision was reversed by the Supreme Court of the United States (*Hatahley v. United States*, 351 U.S. 173, 76 S.Ct. 745, 100 L.Ed. 1065) and the case was remanded to the trial Court for specific findings as to damages. Upon remand, the District Court took additional evidence on the issue of consequential damages and, without an amendment of the complaint, entered a judgment against United States for the total sum of $186,017.50. This second judgment was reversed by the Tenth Circuit in *United States v. Hatahley*, 257 F.2d 920 (10 Cir. 1958). In its opinion, the Court said:

"Somewhat in analogy to the procedure outlined in Cooke v. United States, 267 U.S. 517, 45 S.Ct. 390, 69 L.Ed. 767, and Offutt v. United States, 348 U.S. 11, 75 S.Ct. 11, 99 L.Ed. 11, we suggest that when the case is remanded to the

> District Court, the Judge who entered the judgment take appropriate preliminary steps to the end that further proceedings in the case be had before another Judge. See La Buy v. Howes Leather Co., 352 U.S. 249, 259, 77 S.Ct. 309, 1 L.Ed.2d 290."

After the mandate was received by the trial Court and during a hearing upon certain motions made by the United States, the trial Court took note of the suggestion of the Court of Appeals that the case be heard before another judge, but stated for the record that he did not "intend to follow that suggestion so you can lay that to one side." The United States then sought relief from the Tenth Circuit. The Court ruled:

> "In view of the whole record before this court, we are convinced that the United States cannot obtain a fair and impartial trial before the presently presiding judge, and that the proper administration of justice requires that further proceedings in the case be heard before another judge. And, it now conclusively appears that the said respondent judge will not heed the court's suggestions that he take proper steps to excuse himself and reassign the case. It is therefore ordered that further proceedings in this case be heard before a judge to be designated by the Chief Judge of this Circuit, pursuant to Section 292(b), Title 28 U.S.C., and that the respondent take no further action herein." (273 F.2d 30)

The Court also stated:

> "When the case was first here in United States v. Hatahley, 10 Cir., 220 F.2d 666, 670, we observed that it had been 'tried in an atmosphere of maximum emotion and a minimum of judicial impartiality.' " (273 F.2d 31)

We submit that the record in this case shows that, from the beginning, it was "tried in an atmosphere of maximum emotion and minimum of judicial impartiality". The original judgment entered by Judge Ritter in the *Hatahley* case was $100,000, but

on remand, he boosted it to $186,017.50. The original judgment in this case was entered against DePinto for the sum of $314,-794.19. After the first remand, Judge Boldt entered a new judgment against DePinto for a like amount, plus interest from October 18, 1957, which amounted to over $100,000. After the second remand, Judge Boldt took the position that the claim against DePinto was not limited to $314,794.19 plus interest, but included an additional claim or claims of over $177,000, which were not found in the current complaints. (R.T. 62-120) When counsel for plaintiff indicated that the triable claims totaled about $825,000, the Court did nothing to disabuse him. (R.T. 154) And, then, when the Duhames agreed to pay $100,000, in full settlement of the claim against them in the amount of $314,794.19, Judge Boldt decided that such payment would not reduce *pro tanto* the claim against DePinto for the identical amount.

There can be no doubt that the Affidavit was timely filed. This was done well in advance of any proceedings taken by the trial Judge after the second reversal. In the case of *Laughlin v. United States,* 344 F.2d 187 (U.S.C.A. D.C. 1965), the Court recognized that an affidavit of bias or prejudice filed after the judge had presided, without objection, for two days over hearings on pre-trial motions, was not timely. The Court said, however:

> "If on remand, however, the case should be assigned to the same District Judge, the affidavit should be considered. If it is found to be legally sufficient, the District Judge should, in accordance with 28 U.S.C. § 144, 'proceed no further' herein."

When Judge Boldt, after the first reversal, gratuitously advised the attorneys for defendants that they should not "go shopping" for another judge, and that he intended to stay with the case until its conclusion, he, at that early date, disclosed a mental attitude which compelled him, over two years later, to ignore De-

Pinto's Affidavit of Bias or Prejudice. Judge Boldt must have felt that, without his guiding hand, justice could not be done for United and its stockholders. The conduct of an overzealous advocate can be ameliorated by the restraints imposed by a good judge. There is no restraint, however, upon an overzealous judge.

We are quite sure that, in his own mind, Judge Boldt has, at all times, felt that he could act with complete impartiality in this case, not only as to DePinto, but as to every other party-litigant. But the question of impartiality goes much farther than the subjective beliefs of the judge with respect thereto. DePinto, as well as every other litigant, is entitled to a trial before a judge who is not only impartial, but appears to be impartial. In the case of *Rapp v. Van Dusen,* 350 F.2d 806, 812 (3 Cir., 1965) the Court of Appeals for the Third Circuit said:

> "For the proper administration of justice requires of a judge not only actual impartiality, but also the appearance of a detached impartiality. Litigants are entitled, moreover, to a judge whose unconscious responses in the litigation may be struck only in the observing presence of all parties and their counsel."

This statement was quoted by the Tenth Circuit in *Texaco, Inc. v. Chandler,* 354 F.2d 655 (10 Cir. 1965). And in *Winebrenner v. United States,* 147 F.2d 322 (8 Cir. 1945), the Eighth Circuit quoted:

> "There is no right more sacred than the right to a fair trial. There is no wrong more grievous than the negation of that right. An unfair trial adds a deadly pang to the bitterness of defeat."

The right to a fair trial, before an impartial judge, is implicit in the Fifth Amendment to the Constitution of the United States. Such constitutional guaranty has been denied to DePinto.

CONCLUSION

We respectfully submit that the judgment against DePinto must be reversed with instructions that the trial Court grant his motion for judgment made pursuant to Rule 50(b), Federal Rules of Civil Procedure. The evidence does not support a judgment against DePinto upon either the issue of liability or the issue of damages. If this Court should take a contrary view, a new trial should be ordered upon any one of the numerous grounds hereinabove discussed—a new trial before a new judge.

In any event, it is clear that a judgment against DePinto for any amount in excess of $80,856 cannot stand.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH S. JENCKES, JR.

(Appendices Follow)

APPENDIX A

The trial Court erred in the admission of evidence over the objection of appellant, namely:

(a) Evidence:

Life Undewriters, Inc., a management corporation, was organized on June 16, 1952. DePinto owned stock in the company, for which he paid $2,000. He knew that its purpose was to sell life insurance. *Objection:* "We object to 21, if your Honor please, on the ground that it is wholly immaterial and irrelevant. It has to do with some company other than the one with which we are concerned, and has nothing to do with the transaction involved in this matter." (R.T. 183)

(b) Evidence:

On October 1, 1952, Life Underwriters, Inc. issued a prospectus for the sale of its stock to the public in which DePinto was listed as one of its directors. For a period of approximately two years, DePinto was a member of the Board of Directors of Life Underwriters, Inc., and presumed that his name was being used as such. *Objection:* "Maybe to shorten, if your Honor please, I would object to (Admitted Facts numbered) 23, 24 and 25, for the reason that these facts could not have any possible connection with the issue in this case, particularly, in view of the fact that we are concerned only with the transaction that took place on October 18, 1957." (R.T. 181)

(c) Evidence:

"DePinto attended a meeting of United directors and shareholders which was held on March 29, 1955. DePinto attended at the request of Kelly and he heard James Burk and Dr. Harry Cumming at that meeting." *Objection:* "To which we object on the grounds that it is wholly irrelevant and could have no connection with October 18, 1957." (R.T. 186-187)

(d) Evidence:

Exhibit 4B. Minutes of a meeting of the Board of Directors of United of March 29, 1955, which include the statement that numerous stockholders were present at the meeting at the request of Dr. Cumming, and most of the discussion was concerned with the dissatisfaction of the stockholders. *Objection:* "I call your attention to the fact, your Honor, that Dr. DePinto was not a member of the Board of Directors at that time. The whole business would be hearsay as far as he is concerned, and it wouldn't prove or tend to prove any issue in this case involving the transaction of October 18, 1957. For the purpose of saving time in the future your Honor, I think you can appreciate that our objections so far have gone to all of the antecedent material, antecedent to October 18, 1957, because you have taken out of the case any issues with respect to any defalcations or mismanagement prior to October 18, 1957. So that this really has nothing to do with this case. * * * Our objections would go to the fact that this is, so far as Dr. DePinto is concerned, pure hearsay." (R.T. 187-191)

(e) Evidence:

DePinto attended a meeting of the Board of Directors of United Security Life in 1955, at which Dr. Harry Cummings appeared. Dr. Cumming complained about the management of United. The meeting was called by Kelly to hear the complaints of one James Burk, to the effect that the company was not being administered properly. *Objection:* "The Court: Any objection to this? Mr. Jenckes: Yes, this has nothing to do with this lawsuit. We are concerned with the transaction that took place on October 18, 1957 also a transaction involving United Security Life. A lot of this has to do with another company." (R.T. 194-197)

(f) Evidence:

Exhibit 4G. Minutes of a meeting of the Board of Directors of United held on November 15, 1955, at which it is stated, among other things, that it was agreed by the Directors that a report of the stockholders meeting and the progress of the company should be sent out to all stockholders at an early date, such suggestion having been made by Dr. DePinto. Finding of Fact No. 59 "Neither DePinto nor Duhame attended the said November 15, 1955 meeting of United's Board of Directors." *Objection:* "Mr. Jenckes: Same objection. The Court: Overruled. Mr. Kohn: I have no objection if counsel wants a continuing objection. The Court: A standing objection on the same grounds to any portion of the Admitted Facts read in each instance. Satisfactory? Mr. Jenckes: It occurred to me I would anticipate if an objec * * * The Court: I will read just ahead of the reading that is made, and in each instance you will be deemed to have made an objection on the same grounds previously stated, and if I do not speak or in any rule, you will understand that your objection is overruled, exception allowed. Mr. Jenckes: Very well, your Honor." * * * "We object on the grounds that it is wholly immaterial and irrelevant and has nothing to do with the transaction of October 18, 1957." (R.T. 199-202)

(g) Evidence:

Exhibit 5F, being the minutes of a meeting of the Board of Directors of United held on February 19, 1957, which state that Dr. Angus DePinto was present in person. Admitted Fact No. 87 says: "Neither DePinto nor Duhame attended a February 19, 1957 meeting of United's Board of Directors." *Objection:* (See continuing objection R.T. 199.) "The same objection, if your Honor please." (R.T. 203)

(h) Evidence:

The minutes of United's Board of Directors state that a meeting of United's directors was held on June 22, 1956. Neither DePinto nor Duhame attended the said June 22, 1956 meeting of United's Board of Directors. *Objection:* (See continuing objection R.T. 199-200.) (R.T. 205)

(i) Evidence:

On July 18, 1956, at a special meeting of United's Board of Directors, Kelly resigned as president and a director of United. DePinto signed a Waiver of Notice of said meeting. DePinto did not read the minutes of the July 18, 1956 meeting and did not know that Kelly had resigned as president and director of United. DePinto remained unaware of Kelly's resignation as president up to and including October 18, 1957. *Objection:* (See continuing objection R.T. 199-200) (R.T. 206)

(j) Evidence:

DePinto thought Kelly was president of United up to October 18, 1957. During his tenure as a director of United, DePinto never made a telephone call to United's office to obtain information concerning United's financial condition. DePinto, during his tenure as a director of United, did not examine the report of the Director of Insurance prepared for United for the year ending in June, 1956. DePinto, during his tenure as director of United, never called at United's offices. It was DePinto's impression that United earned a profit for the year 1955, whereas it actually sustained a loss. DePinto did not know whether United earned a profit or not in the year 1956. DePinto did not know who were the officers of United from July 18, 1956 to October 18, 1957. DePinto never wrote a letter or sent a notice of any kind to the shareholders of United that he did not intend to actively participate as a director of United. *Objection:* (See continuing objec-

tion R.T. 199-200) Also see page 207: "Mr. Jenckes: As I understand it, our same objection goes to all of this? The Court: Yes it does." (R.T. 208-209)

(k) Evidence:

Exhibit 83, Kelly's federal income tax return for the year 1957, showing that Kelly valued and paid income tax on assets transferred to him at the full value to him of $308,000. *Objection:* "That would be completely and wholly inadmissible. It would be wholly hearsay, as far as Dr. DePinto is concerned." (R.T. 224) "Same objection." (R.T. 329)

(l) Evidence:

Exhibit 16, constituting page 61 of a report prepared by Mr. Guy L. Hammett, Senior Examiner for the Insurance Department of Arizona. Page 61 appears to be a summary of operations of United for the year ending December 31, 1957. *Objection:* "First of all Exhibit No. 16 purports to show certain things with respect of assets and liabilities and surplus etc. of United Security Life as of December 31, 1957. It is quite obvious, your Honor, there could have been many, many changes that could have occurred in the assets or liabilities of that company between October 18, 1957 and the end of the year, for which Dr. DePinto, of course, would not be responsible for in any way, shape or form. So that first of all, the evidence would be completely immaterial and irrelevant. It wouldn't help out in this case. It would not prove or disprove any material issue. * * * Thus, this Circuit and most of the other Circuits would—which have passed on the question, have held that the facts stated in the document must have been within the personal knowledge and observation of the recording official or his subordinates, and that reports based upon general investigations and upon information gleaned second-hand from random sources must be excluded." Citing *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954). (R.T. 239-249, 264)

(m) Evidence:

At the close of business on October 17, 1957, there was a deficit in the capital stock and surplus of United. The financial statement of United for the period ending December 31, 1957, shows a deficit in surplus in the amount of $352,844.56. *Objection:* "To which we object on the grounds, if your Honor please, that this report was made in conjunction with other people and was made after discussing these matters with the individuals and is not necessarily a report or opinion predicated upon anything other than hearsay testimony. Furthermore, the record discloses that he didn't make a report as of October of 1957. All of his conclusions were with respect to December 31, 1957 and for that reason we object to that testimony." (R.T. 262-263)

(n) Evidence:

In addition to his medical practice, Dr. DePinto has substantial investments. *Objection:* "This is immaterial. * * * Well, if your Honor please, we reiterate it is wholly immaterial and irrelevant to any issue in this case." (R.T. 506-507)

(o) Evidence:

For two years, Dr. DePinto let things run the same way—the signing of minutes of a meeting which said you were there when you never were there. *Objection:* This is highly immaterial and irrelevant. (R.T. 511-512)

APPENDIX B

The trial Court erred in rejecting evidence offered by appellant, namely:

(a) Evidence:

Kelly was introduced to Ballantyne and Niesz by Croydon some 30 days prior to October 18, 1957. They presented to Kelly a program for the purchase of his stock and he agreed if the plan were feasible and acceptable to the Insurance Commissioner and Sureties Commissioner, they could probably get together. Kelly was told that a man from Montana intended to invest a substantial sum of money in the transaction. This was Dr. Sabo. *Objection:* "If your Honor please, to the balance we object. I think your Honor has ruled on that objection. I think that testimony all becomes abortive. It is completely immaterial." (O.T. 442-443; R.T. 294-295)

(b) Evidence:

A man by the name of Tompane was going to arrange for approximately $500,000 worth of mortgages to be assigned over to American, which would put about a quarter of a million dollars in additional surplus in United. *Objection:* "The same subjects your Honor ruled on." (O.T. 474; R.T. 302)

(c) Evidence:

Kelly knew Croydon and Niesz and that, although they weren't wealthy, they were responsible financially. (O.T. 475; R.T. 303-304)

(d) Evidence:

Mr. Earl Glenn, former Securities Commissioner of the State of Arizona, looked over the agreements before they were signed. "He passed it as being regular." "The Court: That is the end there." (O.T. 482; R.T. 308)

(e) Evidence:

According to Kelly, the details of the transaction (consummated on October 18, 1957) were checked with the Director of Securities and the Insurance Department of the State of Arizona. Niesz and Tompane went to the Director of Securities and Croydon and Heineman went to the Insurance Department. *Objection:* "The rest is objected to." (O.T. 434; R.T. 310)

(f) Evidence:

Kelly was told that there was a large investor in American and that he was putting more money into it. *Objection:* "The next is objected to, Sir." (O.T. 485; R.T. 311)

(g) Evidence:

At one time, Croydon and Heineman had Kelly's shares of stock sold to other parties at a figure of about $440,000. An insurance company that has $27,000,000 worth of policies outstanding has value to the corporation in excess of the actual admitted assets contained on the balance sheet. The amount of insurance outstanding would be a basic consideration in determining the sales price of insurance company stock. *Objection:* "That is objected to, completely immaterial, and there was no sale." (O.T. 498; R.T. 316-317)

(h) Evidence:

After Croydon and Heineman visited the Insurance Commissioner, Kelly called him and was told that the plan as presented would be approved. *Objection:* "That is objected to." (O.T. 517; R.T. 321)

(i) Evidence:

During the week, including October 18, 1957, the plans were formulated and checked and they went out to the Insurance Com-

missioner and the Securities Director. *Objection:* "The next is objected to." (O.T. 531; R.T. 322)

(j) Evidence:

During the meetings of the week of October, 1957, which were attended by Goss, Heineman, Croydon, Neisz, Ballantyne and Kelly, et al., Kelly was told that mortgages would be forthcoming to American. Kelly was told by Niesz, Ballantyne, Heineman and Croydon that the mortgages would be coming through Mr. Tompane of Phoenix Title & Trust Company and that he was getting them from people who had mortgages in trust with Phoenix Title. *Objection:* "The next is objected to, Sir." (O.T. 532-533; R.T. 323)

(k) Evidence:

On October 18, 1957, United had some $27,000,000 of insurance in force, of all kinds of policies; life, annuity, life insurance, and certain types of life insurance. *Objection:* "Objected to, that is the same subject to which your Honor sustained an objection just a while ago." (O.T. 553-555; R.T. 324)

(l) Evidence:

Based upon his actuarial experience, Croydon made an estimate of the value of Kelly's stock in United. Based upon such valuation, he fixed an asking price for Kelly's stock somewhere in the range of $600,000. Croydon's valuation was around $450,000. This was in June of 1957. In negotiating with another company, a sales price of $405,000 for Kelly's stock was agreed upon. *Objection:* "This testimony is immaterial." (O.T. 927-930; R.T. 334, 337)

(m) Evidence:

Exhibit 101. A telegram from Croydon to Landoe, dated October 14, 1957, and reading:

"PRB032 LB243 (40)

"L PFC 350 LONG PD=PHOENIX ARIZ 14 330 PMM=
"HJALMER LANDOE, ATTY= 1957 OCT 14 PM 3 56
"BOZEMAN MONT:

"WE SELL 349,000 ASIC STOCK TO UNITED FOR CASH BOND ETC WE USE THIS MONEY PLUS 51,000 TO PURCHASE 40 PERCENT OF UNITED STOCK. UNITED EXCHANGES 349,000 ASIC STOCK FOR MORTGAGES WHICH ARE ADMITTED ASSETS WITH AN OPTION TO REBUY STOCK ON A YEARLY BASIS USING MORTGAGE INCOME MORTGAGE HOLDER WILL GAIN 2 PERCENT PLUS PRESENT INTEREST ON MORTGAGES IN FORM OF CAPITAL GAIN DUE TO OUR REPURCHASING STOCK AT INCREASED PRICE TO COVERM THIS. STATEWIDE BUYS PROFITS FROM ANNUITIES FROM UNITED FOR 300,000 PAYABLE AT RATE 15,000 PER YEAR. MINIMUM PROFIT ON ANNUITIES 12,000 PER YEAR MAXIMUM 55,000 PER YEAR FOR 28 YEARS. ASIC GUARANTEES PAYMENT BY STATEWIDE BY SELLING 300,000 STOCK FOR 300,000 MORTGAGES WITH SAME OPTION TO REPURCHASE. UNITED WILL YIELD PROFITS OF 75,000 PER ANNUM BASED ON PRESENT INFORCE. WE WILL REACTIVATE SALES FORCE AND SELL SPECIAL POLICY ON WHICH WE CAN SHOW A FIRST YEAR GAIN. UNITED HAS 6.6 MILLION INSURANCE PLUS 18.5 MILLION ANNUITIES. BEFORE THE YEAR IS OUT WE WILL TRADE ANOTHER 25,000 ASIC STOCK TO UNITED FOR CASH AND USE THIS CASH TO BUY TREASURY STOCK AT 1.00 PER SHARE TO INCREASE ASIC HOLDING OF UNITED STOCK AT 51 PERCENT. AS ASIC STOCK IS REDEEMED FROM MORTGAGE HOLDERS WE WILL CONTINUE TO EXCHANGE IT FOR OTHER MORTGAGES. AT END OF FIVE YEARS WE WILL HAVE OPTION TO REDEEM ALL OUTSTANDING STOCK BY EXCHANGING SAME MORTGAGES REDUCED BECAUSE BY

THEN ASIC STOCK WILL BE ADMITTED ASSET FOR UNITED. THIS GIVES US A FULL LEGAL RESERVE COMPANY WITH 100,000. CAPITAL AND 350,000. SURPLUS WHICH SURPLUS MAY BE USED TO ACTIVATE ALL OUR OTHER LEGAL RESERVE COMPANIES OR TO PURCHASE OTHER MANAGEMENT CONTRACTS OR COMPANIES INCLUDING BOTH LARGE ONES SPOKE OF PREVIOUSLY. HOW SOON CAN WE EXPECT PEG. BEST REGARDS=

R B CROYDON="

Objection: "Object to its materiality." (R.T. 344)

(n) Evidence:

On September 12 and 13, 1957, Croydon and Heineman met with representatives of The Insurance Corporation of America in Cincinnati. The Insurance Corporation proposed to buy Kelly's stock in United. The mechanics were that United would purchase from Insurance Corp. $308,000 worth of stock of Michigan Securities to be paid for by $308,000 of assets involved in this case. Kelly was to receive $405,000, as the purchase price of his stock in United. InsuranceCorp. withdrew from the transaction. Croydon then suggested to Niesz that they acquire Kelly's stock. Croydon discussed the matter with Mr. Bushnell and was advised that Croydon's proposal to have American buy the Kelly stock could not be done. Niesz suggested to Croydon that they confer with Mr. Tompane for the purpose of determining whether assets could be made available to American or United. Heineman and Croydon discussed the matter with Tompane and were advised that $1,000,000 worth of mortgages could be obtained. It was agreed that $650,000 worth of mortgages would be sufficient to do the job. Mr. Toll, the Securities Commissioner, advised that a prospectus would not be required for United to buy the stock of American or for the acquisition of mortgages through Mr. Tom-

pane. These transactions would be exempt under the Securities Act. On October 18, 1957, Croydon thought that mortgages had been made available through Mr. Tompane. Among the assets transferred to American by United Finance Company in the amount of $86,000 which Croydon did not believe would qualify as an admitted asset. The status of the McKinley mortgage in the amount of $33,424.12 was doubtful. The transaction disclosed by plaintiff's Exhibit 5H included the purchase by Statewide Benefit of United's future income from annuity contracts for a purchase price of $300,000. At the time of the transfer of the American stock to United, the American stock had value. *Objection:* "The next questions are hearsay and are actually contrary to fact. They are hearsay." (O.T. 958-974; R.T. 355-362)

(o) Evidence:

Kelly had approximately 40% of the stock in United which had a value in the neighborhood of $450,000. The remaining 60% of the stock had a value of $1,120,500. If $308,000 in assets were removed from the company, it would not follow that the stock in the company, 100% of the stock, was valueless. This would be true, even though, under the technical insurance law, the company might be referred to as "impaired". (O.T. 1012-1013; R.T. 376)

(p) Evidence:

When Croydon went to the meeting in the office of Jennings, Strouss, Salmon & Trask on October 18, 1957, he believed that American had the mortgages—that they were committed, were available and that it was a matter of mechanics for a physical transfer. Croydon's belief in this respect was based on his conversation with Mr. Niesz and Mr. Tompane. Mr. Niesz had conferred with Mr. Goss, who was to take care of the mechanics. (O.T. 1019-1020; R.T. 377)

(q) Evidence:

An impaired insurance company can have marketable value. A company who operates at a loss can be sold for money. A company can have $6,000,000 worth of business that people will pay for. You have $18,000,000 of annuities which have very real value. It is possible that the value of the stock of the insurance company would be greatly in excess of the capital and surplus. (O.T. 1023-1025; R.T. 379)

(r) Evidence:

Within a week before the deal was consummated, Niesz had a conference with Kelly, Croydon, Heineman and Dunn. The meeting was about October 14. After the meeting, Niesz and Croydon went down to see Mr. Tompane at Phoenix Title & Trust Co., to see whether or not the assets were available immediately on the mortgage trade-out deals. On numerous occasions, Tompane had told Niesz about the mortgages that would be available on a stock trade-out with an organization or vehicle of this type. So, when the situation arose, Niesz went directly down to see Mr. Tompane. Croydon explained to Tompane about the amount of assets and financing that would be possible to take over United and Tompane agreed that it would be a very lucrative situation, that he was willing to cooperate and would furnish the assets. *Objection:* "So that I think this is completely immaterial. It is no defense to them. It is simply dragged before the jury as an extraneous, irrelevant matter, a matter which your Honor has ruled on again and again * * *." (O.T. 600-602; R.T. 484-487)

(s) Evidence:

Through the transaction of forming American and acquiring United stock, Niesz was guided, in part, by some attorney's advice. Harry Goss was Niesz' personal attorney. Heineman represented

American. Both Goss and Heineman knew that assets were to be taken out of United and paid over to Kelly. Goss and Heineman told Niesz that the transaction was illegal, but with the understanding of the plan of mortgages which had been discussed with the Securities Division and the Insurance Department, they thought it was proper. To satisfy himself that the mortgages were available, Niesz had endless meetings with Mr. Tompane, who assured Niesz that they should go ahead with the deal and he would have the mortgages. Niesz expected to get the mortgages immediately after the transaction. Tompane told Niesz and Croydon to go ahead with the deal and he would supply the mortgages. Agreements were signed in the office of Jennings, Strouss, Salmon & Trask on October 18, 1957. By 5:00 P.M. on that day, assets were delivered to Mr. Kelly. The following Monday morning, Niesz went to see Tompane. Niesz then found out that Tompane had only prospective mortgage holders, it wasn't a reality. He didn't have them. He hoped to get them. Tompane had prospects lined up that he had talked to by phone or was going to talk to, but at the moment, he didn't have one red nickel of them. (O.T. 659-663; R.T. 488)

(t) Evidence:

Niesz is 46 years old and has lived in Arizona 13 years. He came to Arizona from Ohio. He has been in the life insurance business in Ohio and Arizona. Niesz organized the American Security Insurance Company in 1954, a benefit company. Mr. Harry Goss represented Niesz, as his attorney, at the time American Security Insurance Company was organized. He retained Mr. Croydon as actuary in 1957. In February of 1957, Ballantyne became associated with Niesz, in the management of American Security Insurance Co. In the middle of October, 1957, Croydon told Niesz that Kelly wanted to sell his stock in United. Niesz, Croydon and Ballantyne had been giving thought to setting up

a management company a considerable time before Niesz knew Kelly's stock was for sale. The price which Kelly was asking for his stock in United, approximately 39%, did not appear to be out of line to Niesz. No one at the meetings held during the week of October 18, 1957, ever expressed to Niesz the idea that the purchase price of the Kelly stock would be paid for some other way than out of the assets of United. It all hinged on the plan of the mortgages all the way through. Heineman, representing United and American, prepared the minutes of the meetings held on October 17 and 18, 1957. On October 18, 1957, Niesz, Croydon, Ballantyne and Heineman knew that the mortgages were not yet finally committed. (O.T. 710-717; R.T. 488)

(u) Evidence:

Dr. Sabo put $115,000 into American; $52,000 on October 18, 1957, $23,000 on October 28, 1957, and approximately $40,000, which was used to purchase the Statewide Benefit Insurance Company. *Objection:* "This is objected to, Sir. This is part and parcel of the same testimony which has been excluded, and this is in no way material." (O.T. 736-738; R.T. 542)

(v) Evidence:

Dr. Francis I. Sabo invested approximately $115,000 in American. Croydon, Pegram, Niesz, Ballantyne and Sabo did not intend to loot United of its liquid assets in order to pay Kelly for his stock. *Objection:* "If your Honor please, I think we have objected to this testimony for several grounds * * * Getting down to the $115,000, we claim this is not material because the $115,000 was not there at the time of this transaction." (O.T. 832, 856, 869; R.T. 356, 489-492)

(w) Evidence:

Niesz and Ballantyne discussed with Eugene Tompane the possibility of acquiring the United stock. They wanted to know

whether or not Phoenix Title & Trust Co. would be willing to act as trustee in holding bonds or mortgages which would be considered as admitted assets, acceptable to the Insurance Department. Tompane advised Niesz and Ballantyne that Phoenix Title would be willing to act as trustee. A number of life insurance companies in the state previously had had a part of their financing obtained by way of certificates of contribution, generally in the form of cash or negotiable securities. The program discussed by Niesz and Ballantyne involved certificates of contribution. Niesz and Ballantyne asked Tompane whether or not mortgages or other securities could be made available from any source. Tompane told them that he knew of one man in particular who sought a higher yield on mortgages held by him. Tompane discussed the matter with the mortgageholder over the telephone. He advised that he would be interested in a proposition if it was acceptable to his attorney. This information was conveyed by Tompane to Niesz and Ballantyne. Tompane accompanied Niesz and Ballantyne to see Mr. Toll, the Director of Securities of the Arizona Corporation Commission. It was Tompane's recollection that Toll advised him that it would not be necessary to "register this as a security". Tompane discussed the matter with Mr. Bushnell over the telephone "to verify certain of the statements that had to be acceptable to the Commissioner, etc." He was advised "that it could be worked out." Subsequent to October 18, 1957, Tompane had a conference with representatives of American with respect to the requirements with respect to a trust document. The person who Tompane had in mind held a mortgage of $175,000. Tompane called him around the end of the year and found that he had died a few days prior thereto. *Objection:* "I think that would be objected to because it is immaterial. * * * That is objected to. * * * That is objected to as hearsay. * * * I take it I have an objection to this?" (R.T. 393-408)

(x) Evidence:

"It is our offer to prove by the witness, Richard Johnson, that he knew Mr. Croydon in the summer in 1957; that he knew his reputation for ability and integrity as an insurance man and an actuary, and that he had an excellent reputation in that respect." *Objection:* "That is objected to." (R.T. 469)

(y) Evidence:

Prior to October 18, 1957, Niesz and Ballantyne each had an excellent reputation for ability and integrity in the insurance business. *Objection:* "Objection, Sir." (R.T. 477-478)

(z) Evidence:

In the summer of 1957, Dr. Sabo had an excellent reputation for professional ability and integrity. Pegram had an excellent reputation for business ability and integrity. In the summer of 1957, Landoe had an excellent reputation for professional ability and integrity. *Objection:* "Objection." (R.T. 523-524)

(aa) Evidence:

At the time of the merger of United with Provident in 1959, it was necessary to increase the surplus or reserves of Provident. Provident did not have sufficient reserves to take over the business in force of United and it necessitated Provident finding ways and means to acquire additional assets to effect the merger. Provident found persons who were willing to assign to it certain assets in the form of first mortgages in consideration of certificates of contribution and the payment of certain interest on assets which were acquired. This would be considered a form of loan. Provident issued certificates of contribution containing certain obligations to pay interest, etc. Defendants' Exhibit F (a form of certificate of contribution) is a form that is supplied by the Insurance Director's Office, Mr. Bushnell's office. Exhibit E is the trust agree-

ment that was entered into between Provident, Mrs. Koozer and Phoenix Title & Trust Co. Exhibit F discloses a contribution of $10,400 in the form of a first mortgage on real estate. Exhibit E and Exhibit F "go together as a bundle." Mr. Bushnell approved the merger. Thereafter, Provident carried on its books as an asset and part of its surplus the mortgages which were covered by the certificate of contribution. A year or two after the merger, Provident secured additional mortgages by way of certificates of contribution. The mortgages are carried on the books of Provident as an asset. *Objection:* "Objection to this question, and to this entire line. * * * I move to strike his testimony, Sir, as immaterial." (R.T. 527-537)

(bb) Evidence:

Dr. Sabo invested $115,000 in American. (O.T. 1094-1095; R.T. 543)

(cc) Evidence:

Hammet's evaluation of 38,000 shares of United stock at zero had nothing to do with the going price of the stock. Hammet did not inquire into any recent sales of stock in United as to what had been offered and what had been paid. Hammet's valuation was not even a computed formula set forth in the Insurance Code. Hammet's opinion as to the value of the United stock had nothing to do with the fair market value of the stock whatsoever. It had nothing to do with what somebody else was willing to pay for it. Hammet's attitude with respect to the American stock was the same. He didn't take into consideration what somebody else was willing to pay for it. The amount of insurance in force by a particular company would have a bearing upon the value of the stock. On October 18, 1957, United had some 6½ million dollars of insurance in force. If Hammet had placed a value thereon of $20 a $1,000, it still would not have had cured the impairment.

United's premium was roughly $180,000 per year. *Objection:* "That is objected to Sir * * * It is the same kind of vague testimony other people are talking about that may have some value, but it never comes to the point where it is probative and cogent evidence for the jury to consider." (O.T. 1060-1063; R.T. 544)

(dd) Evidence:

"113* During August of 1957 Sabo had three discussions with Ballantyne in Bozeman, Montana about the formation of a holding or investment company to acquire life insurance companies in Arizona.

"114 No persons other than Sabo and Ballantyne were present at any of the three discussions which took place in August of 1957.

"115 Pegram first talked with John Ballantyne in Bozeman, Montana during August of 1957. The conversation was held at the request of Sabo who asked Pegram to find out what the latter could do about a proposal made to Sabo by John Ballantyne that Sabo invest in a proposed life insurance management company in Phoenix, Arizona.

"116 During the August, 1957 conversation with Ballantyne in Bozeman, Pegram was told of a plan for setting up a holding or management company for the purpose of acquiring interests in life insurance companies and entering into management contracts with beneficial life insurance companies in Arizona."

Objection: "If your Honor please, I think this whole subject from here on involves other people, other defendants." (T.R. 103-104, R.T. 518-519)

(ee) Evidence:

"121 After talking with Ballantyne, Sabo sent Pegram, his 'closest and most trusted friend' and a business associate, to Phoenix to investigate 'this possibility of an investment'.

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*Nos. 113, et seq. refer to the numbers of the "Admitted Facts" contained in the Pretrial Order.

"122 Pegram asked Landoe, an attorney from Bozeman, Montana, to come along with him on the early September, 1957 trip to Phoenix for Sabo.

"123 Landoe is a lawyer who practiced law in Bozeman, Montana during 1957. He has practiced law in Montana for 33 years, is a graduate of the University of Missouri at Kansas City where he received an LL.B. degree in 1932, and also attended Montana State College. During his years of practice he has counseled and advised clients with respect to matters involving corporate law.

"124 Landoe had previously acted as Sabo's attorney.

"130 During the conversations and meetings held on or about September 10, 1957 in Phoenix between Pegram, Landoe, Croydon, Niesz and Ballantyne, the main subjects discussed were the setting up of a management company to manage and acquire life insurance companies, the amount of capital needed to accomplish such an objective, the feasibility of such a company, and how such a company would operate.

"131 During his September 10, 1957 stay in Phoenix with Pegram, Landoe talked to Harry Goss and Eugene Tompane about the reputation and financial responsibility and experience of Croydon, Niesz, and Ballantyne, and talked with each of the latter three men about the financial responsibility and reputation and experience of the others.

"135 After returning to Bozeman, Montana after the September 10, 1957 trip and meetings in Phoenix, Arizona, Pegram and Landoe conveyed to Sabo the information which they had obtained in Phoenix concerning the formation of the investment or holding company which was to acquire and manage life insurance companies.

"136 Landoe and Pegram recommended to Sabo that if he was interested in the proposal to form an investment or holding company to acquire and manage life insurance companies, he should go to Phoenix and look into the matter personally.

"140 On the second trip to Phoenix on or about September 27, 1957, Landoe again went with Pegram at the request

of Sabo. Sabo went to Phoenix by himself, and Landoe and Pegram met him there.

"141 The purpose of the second trip to Phoenix, Arizona, made by Sabo, Pegram and Landoe, on or about September 27, 1957, was to discuss the proposal to form a holding company which was to acquire and manage life insurance companies.

"143 While in Phoenix, Arizona, on or about September 27, 1957, Sabo, Pegram, Landoe, Croydon, Niesz and Ballantyne did discuss the formation of an investment or holding company to acquire and manage life insurance companies.

"149 Niesz, Croydon, Ballantyne, Goss, Landoe and Pegram were the only persons with whom Sabo talked, while in Phoenix, about the formation of an investment or holding company to acquire life insurance companies in Arizona.

"150 Landoe talked only with Goss, Tompane, Croydon, Niesz and Ballantyne concerning the reputation, financial stability and experience of Croydon, Niesz and Ballantyne.

"155 On or about September 28, 1957, while in Phoenix, Arizona, Sebo entered into a verbal preincorporation agreement with and among Pegram, Landoe, Croydon, Niesz, and Ballantyne, to form a corporation to be known as American Security Investment Company.

"158 At the pre-incorporation meeting of American held on or about September 27, 1957, it was stated by Sabo that he had $115,000.00 to invest in the holding company, and that he could acquire additional capital.

"159 Sometime during the meetings during the September 27, 1957 stay in Phoenix, Sabo stated that he would subscribe to stock in the investment or holding company to be formed, and would invest the sum of $115,000.00 at about the time of the formation of such company and would make arrangements to secure additional capital as it was needed.

"160 It was Sabo's understanding that he was to raise $115,000.00 to be invested in American Security Investment Company upon organization."

Objection: "The same objection." (T.R. 104-109, R.T. 520)

(ff) Evidence:

"178 After American Security Investment Company was organized, Sabo owned over fifty (50) per cent of the voting stock.

"188 Sabo wired or telegraphed $52,000 to American on October 18, 1957 at the request of Croydon.

"189 Prior to October 18, 1957, Landoe knew that Sabo planned to send money to Phoenix to the credit of American."

Objection: "The same objection." (T.R. 110-112; R.T. 520)
Evidence:

Exhibit 50A, consisting of the Pre-Incorporation agreement executed by the incorporators of American. *Objection:* "This is objected to Sir. It is an undated Pre-Incorporation Agreement. * * * It would be very prejudicial and misleading to the jury." (R.T. 543-544)

(gg) Evidence:

"266 On February 7, 1959, a merger agreement was entered into between United Security Life and Provident Security Life Insurance Company. The terms of that agreement provided that 38,798 shares of United stock theretofore held by American Security Investment Company were to be cancelled, and all rights therein relinquished and released. Subsequently, in 1959, the said 38,798 shares of United stock were delivered to Provident Security Life Insurance Company and cancelled."

Objection: "Your Honor ruled on that subject this morning." (T.R. 132; R.T. 521)

APPENDIX C

The trial Court erred in its charge to the jury, namely:

(a) Charge:

"The particular acts or omissions on the part of the defendant DePinto, which plaintiffs allege occurred and amounted to negligence or breach of fiduciary duty are as follows: Acceptance of the office of director without intending to discharge the duties and responsibilities of director; delegating or relinquishing his responsibilities as a director to Kelly; failing to attend directors' meetings; failure to examine minutes, records and transactions and documents of the corporation; failure to keep himself advised by reasonable inquiry as to important transactions of the corporation; and particularly as to the transactions in question resulting in the transfer to Kelly of corporate assets; failure to investigate and to require measures for protection of the corporation with respect to conditions and transactions potentially harmful to the corporation and stockholders when such were brought to his attention or of which he should have learned in the exercise of reasonable care to assure that adequate funds, property, and security be obtained by the corporation in return for the transfer to James E. Kelly of substantial assets of United Security Life." (R.T. 570)

Objection:

"Now, with respect to the instructions, we first except and object to the instruction with respect to the contentions of the plaintiff in this matter, and you referred to particular acts, such as acceptance of office without intending to perform the duties of the office delegating responsibilities, failure to keep advised, failure to investigate, and so forth.

"It is our position, if your Honor please, that the charge that was made against the defendant as found in Count 6 and Count 7 of Plaintiff's complaint, that in Count 6 the only charge is that DePinto caused United Security Life to transfer $314,794.19, and so forth. That is one of the charges.

"Further, that he was liable for breach of duty by permitting the defendant United Security Life to enter into the agreement for the transfer of the assets, and in Count 7 it is charged that the defendant negligently transferred control of United to Croydon, Sabo, and so forth.

"Under the circumstances, your Honor, when you charged the jury that if the dependant DePinto was guilty of failing to do what you have indicated, or had breached his duty, as you have laid down, you departed from the charges that were made against him in the complaint, and under those circumstances, the jury would be in a position to bring in a verdict against him if he found that DePinto was guilty of some deriliction as the Court had permitted him to do, rather than as claimed in the pleadings." (R.T. 597-598)

(b) Charge:

"However, any of the following acts or omissions, if determined by the jury to have resulted from a failure to exercise reasonable care, may be found to constitute negligence and breach of fiduciary duty chargeable to a director, failure to attend directors' meetings, failure to examine minutes and transaction documents subject to a director's approval, failure to make reasonable inquiry as to important transactions of the corporation, and failure to act wtih respect of conditions and transactions potentially harmful to the corporation and its stockholders when such are brought to the director's attention, or of which he should have learned as a director exercising reasonable care." (R.T. 578)

Objection:

"Again, that matter was repeated by the Court when you advised the jury that Dr. DePinto could be held guilty of negligence by failing to attend, by failing to examine minutes, and so forth, and these matters are not really at issue in the case. The only issue in the case was whether or not Dr. DePinto was negligent in participating in the election of the Niesz group, and whether he is guilty of negligence with respect to these other matters has nothing to do with

whether or not he was liable for the transactions occurring on October 18, 1957, because his failure to attend and examine minutes and so forth could not under any circumstances have been the proximate cause.

"We feel by giving those instructions, Dr. DePinto was prejudiced." (R.T. 598-599)

(c) Charge:

"The law does not permit a director of a corporation to remain silent and inactive when he knows or in the exercise of reasonable care by him, he should know, that an illegal transaction, or one potentially harmful to the corporation is being attempted by officers or other directors of the corporation. Each individual director must make such efforts as are required in the exercise of reasonable care, on his part, to prevent the consummation of such transactions unless and until reasonable and adequate precautions be taken to protect against loss by the corporation.

"If by negligent acquiescence, a director permits corporate assets to be diverted or transferred to the loss of the corporation, such director is liable to the corporation for damages proximately resulting therefrom." (R.T. 579)

Objection:

"You gave the instruction that a director cannot remain silent while an illegal transaction is being attempted, and he must make an effort to be present at the directors' meetings, and he can be held liable for acquiescence with respect to acts taken at a Board of Directors' meeting. This we believe, your Honor, would give the jury leeway to conclude that Dr. DePinto had in some way participated in or acquiesced in the resolution adopted by the Niesz group, and at that time when Dr. DePinto was not a member of the board of directors, and under those circumstances he could not be charged with the responsibility on the basis of acquiescence. In other words, if he wasn't a director at that time, he had no duty to know what was going on at that meeting

and couldn't be charged with acquiescence in the meeting with respect to which he was not a member of the Board." (R.T. 600)

(d) Charge:

"A resignation specified therein to take effect upon acceptance does not become effective until it is accepted." (R.T. 582)

Objection:

"The Court instructed the jury with respect to resignations and that they would take effect only upon the acceptance and so forth.

"There really wasn't any issue in the case with respect to that matter, your Honor, because it was admitted that Dr. DePinto's resignation was accepted, so there wasn't any question of it having taken place.

"The objection to the instruction is that might leave some doubt in the minds of the jury as to whether or not his resignation had become effective." (R.T. 600)

(e) Charge:

"The fact that a director was not personally present at a particular directors' meeting at which a transaction later in controversy was approved will not in itself relieve the absent director from a director's responsibility for such transaction.

"In this connection you are instructed:

"1. The absent director received prior notice of the meeting as prescribed in the corporate by-laws and practice, or approved a waiver of such notice, he will be held responsible for corporate action taken at the meeting unless within a reasonable time after the meeting, he takes reasonably adequate steps to have his objection and dissent to such action specifically recorded in the minute records of the corporation.

"2. If an absent director did not receive or waive notice of such meeting, but he actually knew, or by the exercise of reasonable care should have known, of corporate approval of a contested transaction, and thereafter the director failed

to take reasonable prompt steps to protest the corporate action and record his objections and dissent thereto in the minute records of the corporation, the absent director would have a director's responsibility for the contested transaction even though he did not attend the meeting, or in the latter instance, waived notice thereof; that is, if he had known of the transactions being conducted at a purported meeting, a special meeting of directors of the corporation held without notice of the meeting as prescribed by corporate laws or waiver thereof by some directors is illegal, and corporate action taken at such meeting is invalid unless afterward ratified. Corporate action taken by some directors at such a meeting thereafter may be ratified by the absence directors at a later legal meeting, or by subsequent corporate transactions pursuant to action taken at the meeting, which is known to and approved by the absent directors.

"While a resolution at a special directors' meeting at which some directors did not have timely notices is invalid, if a director does not object to such resolution or action taken pursuant thereto within a reasonable time after he has, or in the exercise of reasonable care should have, acquired knowledge of corporate action taken pursuant to such resolution, the director's failure to object to such corporate action may be found to be ratification of such director of the resolution taken at the meeting otherwise invalid as to him." (R.T. 583-584)

Objection:

"Then you gave a couple of instructions, your Honor, which I think possibly you may have inadvertently done. They appear to be applicable to the defendant Duhame rather than to the defendant DePinto, because it talks about if he received notice, and then if he learned about it, and doesn't object about what occurred at that meeting, why, then he can be held liable, a corporate action by some directors that an illegal meeting may be ratified, and there could be no such issue in the case so far as the defendant DePinto is concerned. There is no showing of any irregular

act that took place by the Board of Directors while he was a member of the Board, and the instructions, if your Honor please, leave the inference that Dr. DePinto was in a position to have ratified what occurred at the meeting on October 18, 1957 at 4:15 when he was no longer a member of the Board of Directors and was not in a position to either repudiate or ratify." (R.T. 600-601)

(f) Charge:

"Although several persons may be adjudged liable for the whole of damages or loss sustained, actual recovery thereon is limited to the total loss sustained. In other words, only a single actual recovery may be made for any item of damage. In these circumstances, if you find defendant DePinto liable, you must not speculate or consider in any way what portion of the total loss that may ultimately actually be recovered from defendant DePinto." (R.T. 587)

Objection:

"We think that that instruction was prejudicial in the sense that it called the attention of the jury to the fact that the Court feels that Dr. DePinto might not have to pay all of this loss. It is our position that there was nothing in the record which justified that instruction, and that by commenting on it, the Judge then brought to their attention the possibility that Dr. DePinto might not have to pay all of this loss, and I think the Court recognizes that if a judgment were rendered against Dr. DePinto, it is certainly possible that he could be held responsible or at least his property could be subjected to the payment of the whole claim.

"So under the circumstances, the jury might very well go out and say, well, Dr. DePinto is only going to have to pay maybe twenty percent of this, so what difference does it make? We think that was prejudicial, if your Honor please." (R.T. 601-602)

APPENDIX D

The trial Court erred in failing to charge the jury in accordance with the requested Instructions of appellant, namely:

(a) Defendant DePinto's Requested Instruction No. 4:

"You are further instructed that even if you find by a preponderance of the evidence that the defendant DePinto was negligent in not making an investigation of the backgrounds and reputations of Croydon, Niesz, Ballantyne, Pegram, Sabo and Goss before participating in their election to the board of directors of United Security Life, your verdict must nevertheless be for the defendant DePinto unless you further find by a preponderance of the evidence that the backgrounds and reputations of such men would justify the conclusion that in all likelihood they would conduct the affairs of United in a wrongful, irregular or negligent manner. In other words, if you find that at the time Croydon, Niesz, Ballantyne, Pegram, Sabo and Goss were placed in control of United Security Life they were reputable business and professional men, then your verdict must be for the defendant DePinto." *Salt River Valley Water User's Ass'n. v. Cornum,* 63 P.2d 639 (Ariz. 1936). (T.R. 82)

Objection:

"If the Court please, the defendant excepts and objects to the charge of the Court to the jury in the following particulars, in failing to give defendant DePinto's requested instruction Number 4, for the reason that it is a correct statement of law applicable to the issues in this case, and in particular, it limits the issues as they are in effect limited by the pleadings and by the evidence." (Tr. 595)

(b) Defendant DePinto's Requested Instruction No. 5:

"You are instructed that you may not render a verdict against the defendant DePinto merely because you should find that while he was a director of United Security Life he failed to give attention to its affairs. The plaintiff in this

action is not entitled to a verdict against defendant merely because it appears that he should have been more active in his duties as a director of United Security Life. And the burden is upon the plaintiff of proving that the performance of the defendant DePinto's duties as a director of United Security Life would have avoided loss and what loss it would have avoided. In order to be entitled to a verdict at your hands the defendant DePinto is not subject to the burden of proving that loss, if any, to United Security Life could have happened whether he had done his duty or not." *Barnes v. Andrews,* 298 Fed. 614 (D.C.S.D.N.Y., 1924) (T.R. 83)

Objection:

"MR. JENCKES: The defendant DePinto excepts and objects to the failure of the Court to instruct the jury fully in accordance with his instruction No. 5.

"I think the record shows that a part of that instruction was incorporated. However, I do not believe that the jury was told that plaintiff in this action is not entitled to a verdict against the defendant merely because it appears that he should have been more active in his duties.

"THE COURT: The very words I used.

"MR. JENCKES: The rest of the instruction, in other words, the second, third and fourth sentences I think you overlooked." (Tr. 596)

(c) Defendant DePinto's Requested Instruction No. 8:

"You are further instructed that unless you find by a preponderance of the evidence that the loss to United Security Life, if any, resulting from the transfer of certain of its assets to American Security Investment Company on or about October 18, 1957, was proximately caused by some negligent act or omission of the defendant DePinto, then your verdict must be for such defendant. To constitute proximate cause such loss must have been the natural and probable consequence of the negligence, if any, of the defendant DePinto, and have been of such character as an ordinarily prudent person ought to have foreseen might probably occur as the

result of such negligence. It is not necessary that the person guilty of a negligent act or omission might have foreseen the precise form of the injury; but when it occurs it must appear that it was a natural and probable consequence of his negligence. If the negligence does nothing more than furnish a condition by which the loss is made possible, and that condition causes a loss by the subsequent independent act of third persons, the two are not concurrent and the existence of the condition is not the proximate cause of the injury. When the act of third persons intervenes, which is not a consequence of the first negligent act or omission, and which could not have been foreseen by the exercise of reasonable diligence, and without which the injurious consequence could not have happened, the first act or omission is not the proximate cause of the injury. If the act of third persons, which is the immediate cause of loss, is such as in the exercise of reasonable diligence would not be anticipated, and the third persons are not under the control of the one guilty of the first act or omission, the connection is broken and the first act or omission is not the proximate cause of the loss." *Salt River Valley Water Users' Ass'n. v. Cornum*, 63 P.2d 639 (Ariz. 1936) (T.R. 86)

Objection:

"Defendant DePinto excepts to the failure of the Court to give his instruction Number 8 in toto. If my recollection is correct, I believe the Court failed to instruct to the effect that if the negligence does nothing more than furnish a condition by which the loss is made possible, that condition causes a loss by the subsequent independent act of third persons, the two are not concurrent and the existence of the condition is not the proximate cause of the injury.

"Further, we believe that the Court failed to give that portion of the instruction reading, 'If the act of third persons, which is the immediate cause of loss, is such as in the exercise of reasonable diligence would not be anticipated, and the third persons are not under the control of the one guilty of the first or omission, the connection is broken and

the first act or omission is not the proximate cause of the loss.'

"It is our position, your Honor, that those portions that I have read of that instruction should be given because they are specifically applicable under the evidence, and they are a correct statement of the law." (Tr. 596-597)

APPENDIX E

In the United States District Court
for the District of Arizona

ALBERT J. DOIG, on Behalf of Himself and All Other Shareholders of Provident Security Life Insurance Company, *Plaintiff,* v. PROVIDENT SECURITY LIFE INSURANCE COMPANY, UNITED SECURITY LIFE, ANGUS J. DEPINTO, ELMER W. DUHAME, FRANCIS I. SABO, EDWIN B. PEGRAM, and HJALMAR B. LANDOE, *Defendants.*	No. Civ. 2974—Phx. AFFIDAVIT OF BIAS OR PREJUDICE

STATE OF ARIZONA
County of Maricopa—ss.:

ANGUS P. DEPINTO, being first duly sworn, deposes and says that he is one of the defendants in the above-entitled action and makes this Affidavit pursuant to the provisions of 28 U.S.C.A., § 144; that the Honorable George H. Boldt, before whom this matter is pending, has a personal bias or prejudice either against Affiant or in favor of Plaintiff; that the facts and the reasons for Affiant's belief that bias or prejudice exists are as follows:

Upon the original trial of this action the jury rendered a special verdict wherein it found that Affiant was not guilty of negligence or breach of fiduciary duty which proximately caused or contributed to cause loss and damage to United Security Life, the predecessor in interest of Provident Security Life Insurance Company. Plaintiff moved that all of the verdicts be set aside and that judgment be entered against Affiant and others in accordance with plaintiff's Motion for a Directed Verdict, which was

made at the close of the testimony. Judge Boldt refused to give effect to the jury verdict and granted judgment for the plaintiff N.O.V. He erroneously refused to recognize the verdict of the jury as having any binding effect.

During the trial, the defendants offered in evidence a Merger Agreement pursuant to which United Security Life had been merged in Provident Security Life Insurance Company after the filing of the action. Judge Boldt rejected the offer and held that there was no issue as to the merger and that any evidence with respect thereto was irrelevant and immaterial. When Mr. Rehnquist, an attorney for one of the defendants, attempted to pursue the matter, he was charged by Judge Boldt with contempt and with attempting to pettifog deliberately and with malice aforethought.

After entry of judgment, Affiant filed a motion for new trial raising numerous legal questions and also pointing out specific errors in the findings of fact entered by Judge Boldt. The Judge apparently gave little, if any, consideration to the motion, notwithstanding the fact that Finding No. 19(d) was contrary to the undisputed evidence.

After the Judgment was reversed by the Court of Appeals for the Ninth Circuit in Cause No. 17114 and the case was remanded to the District Court for further proceedings, Judge Boldt again failed to give objective consideration to the legal and factual questions raised by Affiant. At a pretrial conference held on March 9, 1962, Judge Boldt admonished attorneys for the defendants that they should not "go shopping" for another judge; that he intended to stay with the case until its conclusion. Insofar as known to Affiant, this warning was wholly unprovoked.

Affiant moved that Judgment be entered in his favor upon the jury's verdict and in the alternative demanded a trial by jury of all of the issues herein. The motion was summarily denied. Notwithstanding Affiant's objections, Judge Boldt entered supple-

mental findings of fact and conclusions of law wherein he failed to correct or modify his original Finding No. 19(d) which was contrary to the evidence. In addition to again entering Judgment against Affiant in the amount of $314,794.19, Judge Boldt erroneously elected to include interest thereon from October 18, 1957, which had the effect of increasing Affiant's liability to the extent of approximately $100,000. The second judgment was reversed by the Court of Appeals in Cause No. 18245.

After the remand of this case to the lower court following the first appeal, Gorsuch filed an action against Provident Security Life Insurance Company for the purpose of attempting to set aside the merger of United Security Life with Provident. In that case Judge Boldt denied a Motion For Summary Judgment filed on behalf of Provident. He then granted plaintiff's Motion For Default and Motion For Summary Judgment. Provident's Motion to have the default set aside was denied. The Court of Appeals held that the failure of Judge Boldt to grant Provident's Motion to open the default was an abuse of discretion. The Court of Appeals also held that Judge Boldt had erred in at least four particulars in entering Judgment setting aside the merger.

On the 24th day of September, 1964, Affiant's attorney, Jos. S. Jenckes, Jr., transmitted to Judge Boldt a letter requesting that he consent to the transfer of this case to another Judge, a copy of such letter being attached hereto as Exhibit "A", and by reference incorporated herein. On October 9, 1964, Judge Boldt wrote a letter to Mr. Jenckes in which he rejected such request, a copy of which letter is attached hereto as Exhibit "B", and by reference incorporated herein.

On the 13th day of April, 1964, attorneys for plaintiffs filed herein a Motion For Summary Judgment on Issue of Liability Only. Notwithstanding the fact that the granting of such Motion will be in derogation of and contrary to the mandate and decision of the Court of Appeals for the Ninth Circuit (*DePinto v. Provi-*

dent Security Life Insurance Company, 323 F.2d 826), requiring a new trial before a jury, Judge Boldt has issued a Memorandum dated November 9, 1964, a copy of which is attached hereto as Exhibit "C", and by reference incorporated herein, which Memorandum discloses that Judge Boldt intends to consider said Motion For Summary Judgment on the merits.

It is Affiant's belief that Judge Boldt is not able to consider the issues involved in this action with an open mind. The record demonstrates the inability of Judge Boldt to view the affairs of United Security Life with that degree of judicial detachment and objectivity which should govern all actions of a trial judge.

Affiant believes that in the light of *Whitaker v. McLean* (C.A., D.C.) 118 F.2d 596, and *U.S. v. Ritter* (10th Cir.) 273 F.2d 30, this Affidavit is timely and within the purview of 28 *U.S.C.A.,* § 144.

ANGUS J. DEPINTO
Angus J. DePinto

Subscribed and sworn to before me this 20th day of November, 1964.

My commission expires: March 4, 1968

ALICE J. FITCH
Notary Public

CERTIFICATE OF COUNSEL

Jos. S. Jenckes, Jr., counsel for Angus J. DePinto, hereby certifies that the foregoing Affidavit is made in good faith.

Jos. S. Jenckes, Jr.
Jos. S. Jenckes, Jr.

Copies of the foregoing mailed
this 20th day of November, 1964, to:

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Attorneys for Sabo and Pegram

Jos. T. Jenckes, Jr.

APPENDIX F

Exhibits

Exhibit Number	Description	Reporter's Transcript Page Nos. Ident.	Rec'd.	Rej'd.
4-B	Minutes of Directors Meeting, United Security Life, 3-29-55	192	193	
4-G	Minutes of Directors Meeting, United Security Life, 11-15-55	201	201	
5-F	Minutes of Meeting of Board of Directors of United Security Life, 2-19-57	203	203	
5-G	Minutes of Meeting of Board of Directors of United Security Life, 10-18-57, 4:00 P.M.	215	215	
5-H	Minutes of Meeting of Board of Directors of United Security Life, 10-18-57, 4:15 P.M.	215	215	
16	Page 61 of Report of examination of the affairs of United Security Life, prepared by Guy L. Hammett	225	264	
32	Cash Journal of United Security Life for 1957	225	283	
33	Ledger of United Security Life, October to December, 1957	225	283	
34	Ledger of United Security Life, October 1956 to October 1957	225	283	
36	Cash Journal of United Security Life for 1956	225	283	
37	General Ledger of United Security Life for 1956	225	283	
38	Stockkholders' List	221	221	
43	Debit transferring $52,000 to American Security Investment Co. from First National Bank of Bozeman, Montana	541	541	
45	Debit transferring $23,000 to American Security Investment Co. by order of Edward B. Pegram	541	541	
50-A	Pre-Incorporation Agreement, American Security Investment Co.	543		544
50-B	Certified copy of Articles of Incorporation, American Security Investment Co.	461	461	
50-N	Minutes of meeting of Board of Directors of American Security Investment Co., 10-18-57, including waivers	215	215	

Exhibit Number	Description	Reporter's Transcript Page Nos. Ident.	Rec'd.	Rej'd.
52	Journal of American Security Investment Co., October 1957 to December 1958	225	283	
53	General Ledger American Security Investment Co., October 1957 to December 1957	225	283	
58	Agreement between American Security Investment Co. and James E. Kelly for purchase of stock	298	298	
59	Agreement between American Security Investment Co. and James E. Kelly for purchase of agent's account	299	300	
60	Agreement between American Security Investment Co. and United Family Guild for purchase of stock	299	300	
83	Income Tax Return of Kelly for 1957	224	300	
85	Photostatic copy of check by United Security Life to American Security Investment Co., October 18, 1957, for $13,588.91	221	221	
86	Photostatic copy of check by United Security Life to American Security Investment Co., October 18, 1957, for $9,057.28	221	221	
97	Prospectus of United Security Life	222		224
98	Prospectus Life Underwriters, Inc.	222		224
101	Telegram to Bozeman, Montana signed by Croydon	344		344
A	Draft of Contract	450	450	
B	Draft of Agreement between American Security Investment Co. and James E. Kelly for purchase of stock	450	450	
C	Draft of Contract	450	450	
D	Appointment of Statutory Agent	483		483
E	Trust Agreement between Provident Security Life Insurance Co., Koozer and Phoenix Title & Trust Co.	536		536
F	Form of Certificate of Contribution	536		536
G	Merger Agreement between Provident Security Life Insurance Co. and United Security Life	541–4		541–4

No. 20553

In the

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

ANGUS J. DE PINTO,

Appellant,

and

JAMES P. DONOHUE, as Trustee in Bankruptcy of the Estate of Angus J. DePinto,

Intervenor-Appellant,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and ALBERT J. DOIG,

Appellees.

BRIEF OF APPELLEES

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No. 20553

In the

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

ANGUS J. DE PINTO,

Appellant,

and

JAMES P. DONOHUE, as Trustee in Bankruptcy of the Estate of Angus J. DePinto,

Intervenor-Appellant,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and ALBERT J. DOIG,

Appellees.

BRIEF OF APPELLEES

For convenience the appellees will use the same designations in referring to the various transcripts of record and testimony as did appellants. Occasionally appellant DePinto will be referred to as DePinto for purposes of brevity as will be the case with respect to Provident Security Life Insurance Company, United Security Life, and American Security Investment Company who may be referred to

as Provident, United and American respectively.

JURISDICTION

This is a stockholders' derivative action. Niesz v. Gorsuch, 9 Cir., 1961, 295 F.2d 909. Jurisdiction was vested in the district court under 28 U.S.C.A. § 1332. (T.R. 83). Judgment was entered against DePinto from which he has appealed. 28 U.S.C.A. § 1291 is the authority for review of such a lower court judgment.

STATEMENT OF THE CASE

Appellees disagree with much of appellants' statement of the case. The reasons therefor are set forth in Appendix A should the court desire to examine them. The following is appellees' statement of the case. There is incorporated by reference herein, for purposes of background information, the statements of appellees contained in each of their earlier briefs filed here in No. 17114 and No. 18245.

1.

Proceedings In Lower Court.

Following the second reversal of judgment against DePinto in the sum of $314,794.19, appellee Doig moved for partial summary judgment as to liability only. The motion was denied. (T.R. 288). Subsequently a 102 page pretrial order was prepared, signed, and filed on June 10, 1965. (T.R. 92-194). The trial court ruled, after

a motion seeking release therefrom by the Duhame Estate, that the stipulations agreed to in the pretrial order of March 9, 1960 were also binding on the parties. (R.T. 30). DePinto has assigned no error with respect to such ruling. And although DePinto objected to the order at the time it was entered and later included it in his statement of points, he has not assigned as error the ruling of the trial judge in the pretrial order that the pleadings pass out of the case upon the entry of such order. (T.R. 194).

After the Duhame Estate settled its liability for the claimed damages sustained by United prior to October 18, 1957, as well as other claimed damages, for the sum of $100,000, the trial court proceeded on the following Monday, June 14, 1965, with respect to DePinto. Previous to that date, and on June 11, 1965, Civil No. 2974 (this action) and Civil No. 3062 (S.E.C. cause of action against Sabo and Landoe) were consolidated and continued upon the request of appellees and Landoe and Pegram. The full detail with respect thereto will be found in Point 8 herein.

At the close of evidence, DePinto moved for a directed verdict. (R.T. 551, T.R. 292). Such motion was denied. (T.R. 292). On June 16, 1965, a general verdict was returned against DePinto in the sum of $314,794.19. (T.R. 262). DePinto moved for judgment in accordance with his motion for a directed verdict, or in the alternative, for a new trial. (T.R. 254, 263). Upon denial thereof,

this appeal was instituted. (T.R. 273, 274).

Following post judgment proceedings, DePinto filed an action seeking a permanent injunction prohibiting execution of the judgment herein against the marital community property of himself and his spouse. Angus J. and Margaret F. DePinto v. Provident Security Life Insurance Company, Civil No. 5609, U.S. District Court, Phx. The appeal from the entry of summary judgment against defendants is pending here. Angus J. DePinto and Margaret F. DePinto v. Provident Security Life Insurance Company and Albert J. Doig, No. 20308.

On August 18, 1965, DePinto and his spouse filed a petition for an arrangement pursuant to Chapter XI of the Bankruptcy Act. (See Exh. D attached to Petition for Writ of Mandamus here in No. 20460). Sworn schedules were filed showing total community debts of $2,113,931.93 and total community assets of $754,109.44. (See Exh. E attached to Pet. in No. 20460). On March 10, 1966, DePinto and his spouse filed a voluntary consent to be adjudicated bankrupt, and James P. Donohue was appointed trustee in bankruptcy. (See Petition of James P. Donohue to intervene here). This court granted the said petition of the trustee in bankruptcy on June 15, 1966. The opening brief of the trustee in bankruptcy and DePinto was timely filed.

The Facts.

DePinto is an educated man having received his undergraduate and medical school degrees at the University of Chicago. (R.T. 181). He began the practice of medicine in Phoenix, Arizona in 1937. (R.T. 181). During his career, DePinto not only practiced medicine, but also successfully managed his own assets and property. (R.T. 181). The investments which he managed were substantial and required his attention and time. (R.T. 507). Among these investments were stores which he owned. (R.T. 507).

In 1947 DePinto met James E. Kelly. (R.T. 182). Subsequent to 1947, DePinto and his wife became very friendly with Kelly and the latter's wife, occupied summer homes next to each other in Carlsbad, California from 1948 until about 1960, entertained each other in their respective homes. (R.T. 182-183). During that period, DePinto made several trips to Carlsbad, California with Kelly via either airplane or automobile. (R.T. 183). The friendship of DePinto and Kelly endured until about 1959 or 1960. (R.T. 183).

In 1952 DePinto worked with and assisted Kelly in promoting a corporation known as Life Underwriters, Inc. as shown below. On June 16, 1952 Life Underwriters, Inc., a management corporation, was formed. (R.T. 183). DePinto understood that the purpose of Life Underwriters, Inc. was to sell life insurance and to take over

smaller companies. (R.T. 183). DePinto owned stock in Life Underwriters, Inc. for which he paid $2,000. (R.T. 183). Kelly was the President and a director of Life Underwriters, Inc., and DePinto was a director. (R.T. 183, 184-185). Prior to October 1, 1952, Kelly discussed with DePinto business affairs of Life Underwriters, Inc. (R.T. 183-184). On October 1, 1952, Life Underwriters, Inc. issued a prospectus for the sale of its stock to the public in which it was stated that DePinto was a director. (R.T. 184). DePinto knew that his name was being used as a director of Life Underwriters, Inc. (R.T. 185).

About a month and a half later, on November 21, 1952, United Security Life was formed. (R.T. 185). Kelly held office as a director and officer of United at its inception and remained in such capacities until July of 1956. (R.T. 185). DePinto knew in late November or early December of 1952 of the corporate existence of United. (R.T. 185). Prior to December 15, 1952, United prepared a prospectus for the sale of its stock to the public. (R.T. 185). That prospectus of United stated under the heading "Relationship with Life Underwriters, Inc." that Life Underwriters, Inc. "is the exclusive operating management and sales agent for United Security." (R.T. 185-186). The prospectus also stated under the same heading that DePinto was a director of Life Underwriters, Inc. (R.T. 186). DePinto presumed that Kelly was using DePinto's name

in a prospectus issued by United. (R.T. 186).

Thereafter United engaged in the dual activities of selling life insurance mainly to members of the armed services and selling its common stock to the public. (R.T. 186). Kelly estimated that between twentyfive and forty persons sold the stock of United to the public. (R.T. 186).

On March 29, 1955, a meeting of United's directors and shareholders was held at which a Dr. Harry Cumming or James Burke complained about the management of United under Kelly. (R.T. 186). DePinto attended this meeting on March 29, 1955, and saw and heard James Burke and Dr. Harry Cumming at that meeting. (R.T. 187). On direct examination by his own counsel, DePinto first testified that James Burke was merely complaining because he (Burke) had been promised a share in United and that Kelly had not fulfilled such promise, and that the meeting ended on a happy vein. (R.T. 499-500). He also testified that Kelly had been given a vote of confidence. (R.T. 500). Later, on cross-examination, he admitted that among the charges which had been made at the March 29, 1955 meeting was that the shareholders were in danger of losing their money. (R.T. 504-505). DePinto also admitted that the charges were serious, and was unable to find any reference in the minutes of the meeting to any vote of confidence having been given Kelly. (R.T. 504-505). In 1960,

five years closer to the March 29, 1955 meeting, DePinto testified that the gist of Burke's complaints was "that things were not going properly with the company and that they were not being admistered properly, and that these stockholders were in danger of losing their money." (R.T. 196).

On October 14, 1955, about seven and a half months after the March 29th meeting, DePinto became a director of United. (R.T. 197). At the time DePinto became a director of United he never intended to be an active member of the board of directors. (R.T. 197). At the time he became a director of United, DePinto had had previous experience as a member of the board of directors of the Phoenix Country Club whose monthly meetings he attended regularly. (R.T. 197). In becoming a director of United, DePinto responded to a request from Kelly that DePinto permit Kelly to "use" DePinto as a member of United's board of directors. (R.T. 198). In agreeing to become a director of United, DePinto allowed Kelly the privilege of DePinto's name. (R.T. 198). At the time he became a director of United DePinto knew that United was selling life insurance to members of the armed forces at government depots. (R.T. 199).

While a director of United, DePinto signed minutes of the directors' meeting of November 15, 1955 stating that he was present in person and participated in the meeting whereas in fact he did not attend such meeting. (R.T. 200-203). DePinto also signed minutes

and a waiver of notice for a directors' meeting of United's board of directors for June 22, 1956 without reading the minutes. (R.T. 205-206). DePinto also signed a waiver of notice of a meeting of United's board of directors for July 18, 1956, and did not read the minutes of said meeting referred to in the waiver. (R.T. 206). At the meeting of July 18, 1956, Kelly resigned as President and a director of United, but DePinto did not know that Kelly had resigned. (R.T. 206-207). DePinto remained unaware of Kelly's resignation as President of United to and including October 18, 1957. (R.T. 207). The minutes of United's board of directors for July 18, 1956 set forth the resignation of Kelly as President and a director of United. (R.T. 206). DePinto signed the minutes of United's board of directors' meeting for February 19, 1957 stating that he was present whereas in fact he did not attend the said meeting. (R.T. 203-204). DePinto thought that Kelly was President of United up to October 18, 1957, and did not know that Kelly had resigned. (R.T. 208).

DePinto never, during his tenure as a director of United, made a telephone call to United's offices to obtain information concerning United's financial condition. (R.T. 208). DePinto, during his tenure as a director of United, did not examine the report of the Director of Insurance prepared for United for the year ending in June, 1956. (R.T. 209). DePinto, during his tenure as a director of United, never

called at United's offices. (R.T. 209). It was DePinto's impression that United earned a profit for the year 1955 whereas it actually sustained a loss. (R.T. 209). DePinto did not know whether United earned a profit or sustained a loss for the year 1956. (R.T. 209). DePinto did not know whether United earned a profit or sustained a loss for the year 1957 up to October 18, 1957. (R.T. 209). DePinto did not know who were the officers of United from July 18, 1956, to October 18, 1957. DePinto never wrote a letter or sent a notice of any kind to the shareholders of United that he did not intend to actively participate as a director of United. (R.T. 209).

It was in the context of the foregoing facts that Kelly decided to sell his stock interest in United sometime in the latter part of 1956 or early 1957. (R.T. 209). Kelly owned sufficient stock in United to give him control thereof. (R.T. 209).

About four or five days prior to October 18, 1957, Kelly suggested to DePinto, in a telephone conversation, that DePinto resign as a director of United in view of the imminent sale of Kelly's stock in United. (R.T. 210). In the same telephone conversation, Kelly told DePinto that the purchasers were buying Kelly's part of United, his stock, and therefore perhaps control of the company. (R.T. 210). DePinto knew at some point in this conversation with Kelly on the telephone, four or five days before October 18, 1957, that the control of United was to be taken over by a new board of

directors. (R.T. 210). DePinto did not, however, know the names of the new board of directors of United. (R.T. 210). DePinto did not ask Kelly for the names of the individuals who were to buy Kelly's stock in United. (R.T. 211). DePinto did not ask Kelly who the new directors of United would be after Kelly's stock was sold. (R.T. 211). When asked to state what steps, if any, he took to ascertain whether the people to whom Kelly proposed to sell his stock were qualified to manage a life insurance corporation, DePinto replied, "absolutely none." (R.T. 211). DePinto took no steps to ascertain whether the persons to whom Kelly was selling the stock were financially responsible persons. (R.T. 211). DePinto did not know and never met the purchasers of Kelly's stock before or on October 18, 1957, or thereafter, until February 23, 1960. (R.T. 211).

On October 17, 1957, at 4:45 p.m., articles of incorporation were filed for American Security Investment Company. (R.T. 210). The articles were filed with the Corporation Commission of the State of Arizona. (R.T. 210). On October 18, 1957, Kelly entered into a written agreement of sale with American whereunder he sold 35,149.89 shares of United stock to American for $325,136.48. (R.T. 212). The incorporators of American were Sabo, Pegram, Landoe, Croydon, Niesz, and Ballantyne who were also directors of American. (R.T. 210). On October 18, 1957, United transferred the following assets to American:

Mortgage loan, H. M. McKinley	$ 31,851.21
Interest accrued on McKinley mtg.	1,572.91
Mortgage loan, F.R. & L. Newville	10,816.67
Interest accrued on Newville mtg.	57.68
Clark County, Nev. # 1 bonds	8,855.60
Interest accrued on Clark C. bonds	84.24
North English, Iowa Coop. Tel. bonds	7,345.25
Interest accrued on North Eng. bonds	85.09
Certificate of Deposit No. 6398, Union Bk.	50,000.00
Certificate of Deposit No. 6399, Union Bk.	50,000.00
Certificate of Deposit No. 25, Bk. of D.	1,012.50
Certificate of Deposit No. 4, Bk. of D.	1,000.00
Promissory notes, United Finance Co.	86,000.00
Interest accrued on United Fin. notes	1,626.88
Check No. 6806 issued to American Sec.	13,588.91
Check No. 6807 issued to American Sec.	9,059.28
Check No. 6808 issued to American Sec.	10,043.78
Cash	6,794.19
Total	$314,794.19

(R.T. 213, O.T.237-239).

On the same day, October 18, 1957, the above assets were transferred by American to Kelly. (R.T. 214). On October 18, 1957, United received 30,800 shares of the Class A non-voting common

stock of American Security Investment Company. (R.T. 214). No other property or money or assets of any kind were transferred by American to United on October 18, 1957, and the minutes of American for October 18, 1957, at 3:30 p.m. state that such shares were issued for the assets above excluding the $6,794.19 and totaling $308,000. (R.T. 215). On October 18, 1957, American did not have a permit from the Securities Division of the Arizona Corporation Commission authorizing the issuance of 30,800 shares of its non-voting common stock to United. (R.T. 215). The minutes of American's board of directors for 3:30 p.m. on October 18, 1957 state that the stock in United to be purchased by it from Kelly was to be paid for by delivering to Kelly the assets described above with the exception of the $6,794.19 in cash. (R.T. 216). The minutes of United's board of directors for October 18, 1957, at 4:00 p.m. state that DePinto was present, show that the directors of American; Sabo, Pegram, Croydon, Ballantyne and Niesz, were installed as directors by DePinto, Nina Dunn, and J.L. Jenkins, (R.T. 217, T.R. 120), and show that DePinto signed the minutes under the word "Approved." (R.T. 217, T.R. 120). The minutes of United's board of directors for October 18, 1957, at 4:15 p.m. state that the

resignation of DePinto is accepted and that a resolution is adopted transferring the $308,000 in assets to American for the 30,800 shares of the latter's common non-voting stock. (R.T. 217, T.R. 123-126). No signatures of anyone appear on the October 18, 1957 minutes of United's board of directors for 4:15 p.m. (R.T. 515, T.R. 126, Exh. 5-H). DePinto's resignation as a director of United Security Life was accepted at "about 4:15 p.m.". (R.T. 518). The signature of the Secretary of United Security Life does not appear on the minutes of United for October 18, 1957, at 4:15 p.m.

Prior to the sale of Kelly's stock to American on October 18, 1957, both Kelly and Croydon, the latter being one of the directors of American after its formation, knew that Kelly was to be paid with $308,000 in assets of United as described above excepting the $6,794.19 in cash. (R.T. 331,382). Kelly knew that he was to receive those specific assets of United's about a week or ten days before October 18, 1957 when the transfer actually occurred. (R.T. 331).

Kelly, the seller of the stock in United to American, consulted with tax counsel in preparing his 1957 federal income tax return reporting the amount received from American. He consulted

with Frank Campbell, a leading tax attorney in Phoenix, Arizona, and reported on his federal income tax return for 1957 that the assets described above, with the exception of the $6,794.19 which he did not receive, had a fair market value of $308,000. (R.T. 307, 329-330). The Insurance Department of Arizona, after a two and one half month examination and audit conducted by a Senior Examiner and his assistant, placed a fair market value of $308,000 on the assets, exclusive of the $6,794.19 in cash, transferred from United to American on October 18, 1957 when it concluded that United's deficit had been increased by $308,000 as a result of the loss of such assets. (R.T. 263-265, Exh. 16 at p. 61). American, the purchaser of the $308,000 in assets, reflected that the fair market value of such assets was $308,000 on October 18, 1957 when it entered such amount on its books and records as the corporation's cost thereof. (Exh. 52). The fair market value of the assets transferred from United to American on October 18, 1957 was $314,794.19.

The 30,800 shares of American's class A non-voting common stock, the corporation which had been formed at 4:45 p.m. on October 17, 1957, had no fair market value according to the Insurance Department of Arizona since it found that United's deficit increased by $308,000 as a result of the October 18, 1957 transfer of the $308,000 in assets in return for the 30,800 shares. (R.T. 264-265, Exh. 16). Croydon, a director of American, and

one of the perpetrators of the looting of United who received a $13,588.91 commission from Kelly therefor, received some of the American common stock for services rendered in 1957 in connection with the formation of the company, and he placed no value on the American stock in his federal income tax return. (R.T. 366). American was in a deficit condition on October 18, 1957. (Exh. 52). Croydon stated that the American stock had no value unless the two management contracts it owned had value. (R.T. 364, 367). The Insurance Department of Arizona placed no value on the two management contracts of American when in its examination and audit for the year ending 1957, it concluded that United's deficit increased by $308,000 as a result of the transfer of assets to United in return for the 30,800 shares of American's class A non-voting common stock. (R.T. 264-265, Exh. 16 at p. 61). The 30,800 shares of American's class A non-voting common stock transferred or issued to United by American on October 18, 1957 had no fair market value.

United was in a deficit condition on October 17, 1957, the day before the transfer of $314,794.19 of its assets to American and then to Kelly. (R.T. 263-265, 374, Exh. 16 at p. 61). Both the Insurance Department of Arizona in its 1958 audit of the year ending December 31, 1957, and Croydon so determined. (R.T. 263, 264, 374, Exh. 16 at p. 61).

ARGUMENT

Even if the judgment here is affirmed, the judgment creditor may collect less than thirty-five cents on the dollar. This is because the DePinto marital community is hopelessly insolvent with total liabilities of $2,113,931.93 and total assets of only $754,109.44. Thus, it is the trustee in bankruptcy who is the real party in interest here. He is, by this appeal, seeking to create a fund, at the expense of the judgment creditor here, for general creditors who extended credit years after the entry of the 1960 and 1962 judgment herein. Therefore, in the following argument, when appellee refers to "appellants," the term encompasses both DePinto and the trustee in bankruptcy.

General Response To Appellants' Liability Arguments.

Each of the appellants' contentions respecting proximate cause, liability, rejected or admitted evidence, and claimed error relating to instructions, rests on the assumption that DePinto was required to defend and was charged with only one act of negligence or breach of fiduciary duty - that of electing the outsiders to United's board of directors. Thus, they say that the "only issue in this case was the question of whether or not the transfer of assets from United to American on October 18, 1957 was proximately caused by the negligence of DePinto in participating in the election of the

Niesz group to the Board of Directors of United." This point is reached by ignoring the pretrial order which contains a long list of other acts of negligence, interpreting the complaint in intervention narrowly, ignoring the amended complaint filed by appellee, ignoring the notice received in 1960 at the trial and again in 1962 of the several claims being made against him, and reverting to a theory of nice pleading which is wholly foreign to both the spirit and the substance of the Federal Rules of Civil Procedure.

What this case actually involved is set forth in several pages of the pretrial order listing many acts of DePinto's negligence and breach of fiduciary which were claimed to have proximately caused the loss to United of $314,794.19 on October 18, 1957. (T.R. 141-146, 148-149, 150-156). Many of these particular acts or omissions were set forth in the testimony of DePinto at the 1960 trial (O.T. 1201-1230), were referred to in the 1960 findings of fact and conclusions of law (O.T. 331-353), and again in great detail in the 1962 supplemental findings of fact and conclusions of law ordered by this court. (O.T. 1712-1745). Thus, the district judge instructed the jury at the close of the evidence as follows:

> "The particular acts or omissions on the part of the defendant DePinto, which plaintiffs allege occurred and amounted to negligence or breach of fiduciary duty are as follows: Acceptance of the office of director without intending to

discharge the duties and responsibilities of director; delegating or relinquishing his responsibilities as a director to Kelly; failing to attend directors' meetings; failure to examine minutes, records and transactions and documents of the corporation; failure to keep himself advised by reasonable inquiry as to important transactions of the corporation, and particularly as to the transactions in question resulting in the transfer to Kelly of corporate assets; failure to investigate and to require measures for protection of the corporation with respect to conditions and transactions potentially harmful to the corporation and stockholders when such were brought to his attention or of which he should have learned in the exercise of reasonable care, and failure to exercise reasonable care to assure that adequate funds, property, and security be obtained by the corporation in return for the transfer to James E. Kelly of substantial assets of United Security Life.

"The defendant DePinto denies each and all of the plaintiff's allegations in every particular. This places the burden of proof upon the plaintiffs to establish by a fair preponderance of the evidence the material allegations of their claim against DePinto that are denied by him.

"The essential issues of the case are:

" 1. Is defendant DePinto chargeable with negligent breach of fiduciary duty in any one or more of the particulars asserted by plaintiffs? If so,

" 2. Did such negligent breach of fiduciary duty of defendant DePinto proximately contribute to causing financial loss and damage to United Security Life, a corporation? If so,

" 3. What was the amount of such loss and damage to United Security Life? " (R.T. 570-571). (Underscoring supplied)

Thereafter, the district judge instructed the jury at length with respect to the law applicable to the various acts of claimed negligence.

For example, he instructed the jury that a particular director who delegates his duties and responsibilities to another and negligently fails to take part in the management of the corporation is liable for the misconduct or negligence of those to whom he delegated his responsibilities which was the proximate cause of loss to the corporation. (R.T. 581). This was the rule set forth in Supplemental Conclusion of Law No. 5 filed by the district judge on March 28, 1962. (O.T. 1734).

In short, the jury was given many acts of negligence or breach of fiduciary duty claimed by appellee to have been committed by DePinto, and it was their job to decide if they had been committed, and if so, did any proximately cause loss to United, and if so, what was the amount of that loss?

Therefore, appellants' appeal and argument is fatally defective when they say there is no proximate cause between one of these acts of negligence - the election of outsiders to United's board - and the loss of $314,794.19 of United's assets to Kelly. There were several other acts of negligence and breach of fiduciary duty submitted to the jury, and appellants cannot overcome the jury's finding of proximate cause between one or more of those acts and the $314,794.19 loss to United by arguing there is no proximate cause, assuming they are correct, between the negligent act of electing the outsiders to United's board and the loss.

For example, there is no dispute at all that DePinto delegated his duties as a director to Kelly, and that Kelly robbed United of $314,794.19 of its assets. That is, the proximate cause between Kelly's acts and the loss is patently clear. Also, there is no argument respecting the conclusion that Kelly was negligent and improper in his conduct toward United. Therefore, the law makes DePinto liable for Kelly's negligence or misconduct. (See a full statement of the law at O.T. 1734). Consequently, how does an alleged lack of proximate cause between DePinto's negligent act in electing the Niesz board and the $314,794.19 loss to United prevent the jury from holding him liable under the above claim of having delegated his duties to Kelly? The same applies to each of the other acts of claimed negligence about which the trial court instructed the jury, and about which DePinto

has said nothing in his opening brief because of his contention that the only question was whether the loss was proximately caused by his negligence in electing the Niesz board.

A cursory reading of the first five points of appellants' brief shows that their request for a directed verdict and a new trial, with the exception of the damages contentions relating to the new trial request, is grounded on their view that the only issue which could have gone to the jury was the limited issue of whether one act of DePinto's negligence - electing the Niesz board - was the proximate cause of United's loss on October 18, 1957. Thus, they have not even attempted to show there is no substantial evidence to support the jury's verdict with respect to the other acts of negligence and breach of fiduciary duty submitted to it. What is the basis of this view of the case?

Originally DePinto objected to the pretrial order provision that "as a result of this pretrial order the pleadings pass out of the case." (T.R. 194). This was because he insisted that plaintiff could only make the claim against him as DePinto stated it. (R.T. 122-123). However, he has not assigned as error that ruling of the district court, and has presented no argument citing any authority in support of his position. Instead he has made an oblique attack on the pretrial order by referring to the very pleadings which the pretrial order stated passed out of the case, and arguing therefrom that the complaint

in intervention only may be referred to, that since DePinto resigned from United's board the Count VI therein could not apply because DePinto could not therefore have "caused" or "permitted" United to transfer its assets to American, and that since Count VII of the complaint in intervention alleges that DePinto negligently transferred the control of United, the only issue which the jury was permitted to hear was whether the transfer of assets from United to American on October 18, 1957 was proximately caused by negligence of DePinto in participating in the election of the Niesz group to United's board of directors. (Br. 28). Thus, he says any evidence admitted with regard to the other acts of negligence or rejected with respect to his sole issue, any instructions rejected with regard to his sole issue, any instructions given regarding the other acts of negligence, constitute error. And finally appellants argue that proximate cause was not possible with respect to the issue as they framed it, and therefore they were entitled to a directed verdict. That is their case in Points 1 through 5 except for the damages issue.

Appellees say DePinto had notice of appellee's claims of several acts of negligence as far back as 1960, that the pretrial order cannot be indirectly attacked as appellants are doing, that the philosophy of narrowly construing a pleading and then finding that any variance between that contruction and the proof is fatal to the pleader and prejudice to the defendant if allowed has not been accepted

in the federal courts for nearly half a century and certainly not since the adoption of the federal rules, that assuming DePinto's resignation was in fact accepted before the assets of United were taken it does not follow that his negligence and breach of fiduciary duty up to the point when the resignation was accepted did not "cause" United to transfer its assets or "permit" United to enter into an agreement whereby its assets were transferred for worthless stock, that Rule 8 requires a short plain statement of the claim and therefore the federal courts do not narrowly limit the issues to a jury as DePinto claims, that Rule 16 negates the contention appellants are making, and that the modern philosophy of pleading is that they do little more than indicate generally the type of litigation that is involved. 2 Moore, Federal Practice § 8.03 at 1607. Appellants have failed to assign as error the entry of the pretrial order with its provisions concerning the pleadings, and have failed to argue with respect thereto. Thus, they have abandoned such a point.

Appellees, in the following material, answer appellant's request for a directed verdict, and then his arguments concerning a new trial. Before reaching the new trial arguments, appellee advances the constitutional argument that a directed verdict cannot be granted after a jury verdict has been returned for the plaintiff. Should the court have a question with respect thereto, it may wish to read that contention first. (See page 52, infra.)

1.

Appellants Have Not Carried Their Burden Of Showing That The Jury Verdict Is Not Supported By Any Substantial Evidence.

Although appellant DePinto stipulated in the pretrial order of March 9, 1960 that there were "no material issues of any material fact as to him",[1] he contended during both the first and second appeals of his to this court that he had been deprived of his right under the Seventh Amendment to have the issue of his liability submitted to a jury. This court gave him the jury trial he sought by so ordering, and reversing and remanding for a new trial.[2] Shortly thereafter, appellee filed a motion for summary judgment on the issue of liability only. On November 9, 1964, U.S. District Judge George H. Boldt directed all counsel of record to file their respective memoranda supporting or opposing the said motion by certain specified dates, and set the said motion for a hearing on December 2, 1964. On November 20, 1964 DePinto filed an affidavit of bias and prejudice in which he alleged:

> "On the 13th day of April, 1964, attorneys for plaintiffs filed herein a Motion For Summary Judgment on Issue of

1. O.T. 261.
2. DePinto v. Provident Security Life Insurance Company, 9 Cir., 1963, 323 F.2d 826.

Liability Only. Notwithstanding the fact that the granting of such Motion will be in derogation of and contrary to the mandate and decision of the Court of Appeals for the Ninth Circuit (DePinto v. Provident Security Life Insurance Company, 323 F.2d 826), requiring a new trial before a jury, Judge Boldt has issued a Memorandum dated November 9, 1964, a copy of which is attached hereto as Exhibit "C", and by reference incorporated herein, which Memorandum discloses that Judge Boldt intends to consider said Motion For Summary Judgment on the merits." (T.R. 66, 67).

Thus, the very prospect of a ruling by the trial court on the issue of DePinto's liability, rather than a submission to a jury, was so horrendous to DePinto that he made the serious charge that Judge Boldt was biased and prejudiced, and assigned as one of the reasons in support thereof the fact that Judge Boldt intended to consider the motion for summary judgment. The motion for summary judgment was denied by Judge Boldt on March 5, 1965. (T.R. 288).

Later, in the pretrial order which was entered on June 10, 1965, DePinto contended that the issues of his negligence, breach of fiduciary duties, proximate cause and the amount of loss to United were "issues of fact to be determined by the jury herein." (T.R. 161).

Nevertheless, and despite his prior insistence upon the submission of such issues to the jury, now that DePinto has had a jury

trial and the general verdict returned was adverse to him, he seeks to overcome that adverse jury verdict by contending that the district court erred in having submitted such issues to the jury for determination. In so contending, at this point, that he got a jury trial but should not have, DePinto, after eight years of litigation, has come full circle - back to the point of beginning.

The appellants' contentions that the trial court erred in denying DePinto's motion for a directed verdict at the close of all of the evidence (Specification of Error No. 1), and in failing to grant his motion for judgment in accordance with his motion for a directed verdict (Specification of Error No. 10), present the sole question of whether there was <u>any</u> evidence to support the verdict of the jury. (Appellants' Questions 1 and 2). In order to determine whether or not appellants have carried their burden herein of proving their contention that there is no evidence in the record to support the verdict, it is first necessary to review the rules respecting the scope of review of a jury verdict and the test to be applied on such review.

a.

<u>Scope Of Review Of Jury Verdict.</u>

In the leading case of <u>Tennant</u> v. <u>Peoria & P. U. R. Co.</u>, 321 U.S. 29, 35 (1944), the scope of review of jury cases is stated to be:

"It is not the function of a court to search the record for conflicting circumstantial evidence in order to take the case away from the jury on a theory that the proof gives equal support to inconsistent and uncertain inferences. The focal point of judicial review is the reasonableness of the particular inference or conclusion drawn by the jury. It is the jury, not the court, which is the fact-finding body. It weighs the contradictory evidence and inferences, judges the credibility of witnesses, receives expert instructions, and draws the ultimate conclusions as to facts. The very essence of its function is to select from among conflicting inferences and conclusions that which it considers most reasonable. Washington & Georgetown R. Co. v. McDade, 135 U.S. 554, 571, 572; Tiller v. Atlantic Coast Line R. Co., supra; Bailey v. Central Vermont Ry., 319 U.S. 350, 353, 354. That conclusion, whether it relates to negligence, causation or any other factual matter, cannot be ignored. Courts are not free to reweigh the evidence and set aside the jury verdict merely because the jury could have drawn different inferences or conclusions or because judges feel that other results are more reasonable."[3]

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3. Reaffirmed in Scintilles v. Inter-Caribbean Corp., 361 U.S. 107, 110, and Gallick v. Baltimore & Ohio R. Co., 372 U.S. 108, 114-115. Cited with approval by this court in Southern Pacific Company v. Heavingham, 9 Cir., 1956, 236 F.2d 406, 409, and by the Supreme

Thus, once a jury has made ultimate findings respecting liability and loss, the defendant is not free to relitigate the factual dispute in the appellate court. Lavender v. Kurn, 1946, 327 U.S. 645, 652. To do so would constitute a denial of plaintiff's rights under that clause of the Seventh Amendment which provides that: "... no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law." In this respect the instant appeal differs from the earlier two appeals in which appellant contended that he was entitled to a trial de novo in this court,[4] and thus asked the court to review the evidence and draw its own conclusions therefrom respecting the liability of DePinto. Review in the instant appeal, being an appeal from a general verdict of a jury, is limited to the questions of whether or not the trial court erred, as a matter of law, respecting its rulings on defendant's motions for a directed verdict, for judgment notwithstanding the verdict, and for a new trial.

Court of Arizona in Apache Ry. Co. v. Shumway, 1945, 62 Ariz. 359, 158 P. 2d 142, 150, wherein it was concluded: "The only remaining question is as to proximate cause... The decision of the Supreme Court of the United States in Tennant v. Peoria & P.U.R. Co., 321 U.S. 29, 64 S. Ct. 409, 411, 88 L. Ed. 520, holds that the jury finding forecloses all questions as to this. All that is required in negligence cases is for the plaintiff to present probative facts from which negligence and the causal relation may be reasonably inferred..."

4. Opening brief of appellant DePinto in No. 17114 at 35.

b.

Standard To Be Applied On Review Of Jury Verdict.

Inquiry upon review of a jury verdict is focused initially and primarily upon the question of whether there is a reasonable basis in the record for the ultimate findings of fact made by the jury. Not only is appellate review of the jury's verdict limited to such inquiry, but as stated in Lavender v. Kurn, supra, it is "only where there is a complete absence of probative facts to support the conclusion (verdict) reached does a reversible error appear." Therein the Supreme Court of the United States stated:

> "It is no answer to say that the jury's verdict involved speculation and conjecture. Whenever facts are in dispute or the evidence is such that fair minded men may draw different inferences, a measure of speculation and conjecture is required on the part of those whose duty it is to settle the dispute by choosing what seems to them to be the most reasonable inference. Only where there is a complete absence of probative facts to support the conclusion reached does a reversible error appear. But where, as here, there is an evidentiary basis for the jury's verdict, the jury is free to discard or disbelieve whatever facts are inconsistent with its conclusions. And the appellate court's function is exhausted when that evidentiary basis becomes apparent, it being immaterial that the court

might draw a contrary inference or feel that another conclusion is more reasonable." (Underscoring supplied)

The language of the Supreme Court in the foregoing sentence which was partially underscored, and which succinctly states the ultimate test on review of a jury verdict, was quoted with approval by this court in Sherwood & Roberts-Kennewick, Inc. v. St. Paul F & M. Ins. Co., 9 Cir., 1963, 322 F.2d 70, 77, n. 8. Stated in another way, the same "total lack of evidence test" was said, in Lyons v. Gilliland, 9 Cir., 1962, 303 F.2d 452, 453, to be that the finding of the jury is binding "unless there is no substantial evidence, whether contradicted or not, to support the jury verdict". (The emphasis on the word "no" was placed there by the court). The standard has also been stated by this court as an inquiry into "whether there is any or sufficient evidence to sustain a verdict." United States v. Oliver, 9 Cir., 1932, 59 F.2d 53, 55.[5] Although it has been stated in various ways, "the rule is clear that on appeal from a judgment based upon a jury's verdict the verdict and judgment based thereon will be sustained if there is substantial evidence in the record in support thereof." Richfield Oil Corporation v. Karseal Corporation,

5. See further Lumbra v. United States, 1934, 290 U.S. 551, 553: "... The question presented is whether there is any evidence upon which a verdict for petitioner might properly be found..." (Underscoring supplied); Quebedoux v. Hammons, 9 Cir., 1927, 22 F.2d 530, 532: "...The rule is too well settled to require citation of authority that, if there is any substantial evidence to sustain the allegations of the complaint, a peremptory instruction to find for the defendant should be refused..." (Underscoring supplied).

9 Cir., 1959, 271 F.2d 709, 712. See also, Flintkote Company v. Lysfjord, 9 Cir., 1957, 246 F.2d 368, 374, 375. Arizona follows the "substantial evidence" rule. Casey v. Beaudry Motor Company, 83 Ariz. 6, 315 P.2d 662, 665-666.

In considering the question of whether there is any substantial evidence in the record in support of the jury's verdict, the following general rules are applicable:

1. It is assumed that all evidence before the jury was properly admitted. Flintkote Company v. Lysfjord, 9 Cir., 1957, 246 F.2d 368, 377; Salt River Valley Water Users' Ass'n v. Barry, 1926, 31 Ariz. 51, 250 P. 356, 360.[6]

2. All facts which plaintiff's evidence tends to prove must be assumed to have been established, and all inferences fairly deductible from such facts must be drawn in his favor. Lumbra v. United States, 1934, 290 U.S. 551, 553; Gunning v. Cooley, 1930, 281 U.S. 90, 94; Sherwood & Roberts-Kennewick, Inc. v. St. Paul F. & M. Ins. Co., 9 Cir., 1963, 322 F.2d 70, 75; Richfield Oil Corporation v. Karseal Corporation, 9 Cir., 1959, 271 F. 2d 709, 712; United States v. Bemis,

6. Since "... the competency of evidence is not properly triable upon a motion for an instructed verdict..." City of Phoenix v. Brown, 1960, 88 Ariz. 60, 352 P. 2d 754, 757, for the reason that a motion for an instructed verdict goes only to the sufficiency of the evidence and presupposes that all evidence was admitted by the court was competent, relevant and material, Salt River Valley Water Users' Ass'n v. Barry, 1926, 31 Ariz. 51, 250 P. 356, 360, appellants' contention that there is no competent evidence to support the jury's verdict respecting damages is not well taken. (See appellants' brief at p. 15).

9 Cir., 1939, 107 F.2d 894, 897; Figueroa v. Majors, 1959, 85 Ariz. 345, 346, 338 P.2d 803, 804; Golfinos v. Southern Pacific Company, 1959, 86 Ariz. 315, 345 P.2d 780, 781; City of Phoenix v. Brown, 1960, 88 Ariz. 60, 352 P.2d 754, 757.

3. A motion for directed verdict may only be granted when a verdict the other way would have to be set aside by the court. Gunning v. Cooley, 1930, 281 U.S. 90, 94-95; Galloway v. United States, 1943, 319 U.S. 372, 395-396; Standard Accident Ins. Co. of Detroit, Mich. v. Winget, 9 Cir., 1952, 197 F.2d 97, 100; Golfinos v. Southern Pacific Company, 1959, 86 Ariz. 315, 345 P.2d 780, 781.

4. Where the evidence on material facts is conflicting, or where on undisputed facts reasonable men may differ as to the inferences and conclusions to be drawn from the evidence or where different conclusions might reasonably be reached by different minds, the jury verdict will be affirmed. Gunning v. Cooley, 1930, 281 U.S. 90, 94; Wong v. Swier, 9 Cir., 1959, 267 F.2d 749, 752; Figueroa v. Majors, 1959, 85 Ariz. 345, 346, 338 P.2d 803, 804; Golfinos v. Southern Pacific Company, 1959, 86 Ariz. 315, 345 P.2d 780, 781.

5. The question of negligence and proximate cause is one of fact to be submitted to the jury, and it is only where the evidence, even though it be uncontradicted, is such that all reasonable men must draw the same conclusions from it that the question becomes one

of law for the court. Gunning v. Cooley, 1930, 281 U.S. 90, 94; Wong v. Swier, 9 Cir., 1959, 267 F.2d 749, 752, 754; Figueroa v. Majors, 1959, 85 Ariz. 345, 346, 338 P.2d 803, 804.

6. Where inconsistent inferences may be drawn from the evidence, it is for the jury to determine which of the inferences shall be drawn, Tennant v. Peoria & P.U.R. Co., 1944, 321 U.S. 29, 35; Gunning v. Cooley, 1930, 281 U.S. 90, 94; Wong v. Swier, 9 Cir., 1959, 267 F.2d 749, 754; Figueroa v. Majors, 1959, 85 Ariz. 345, 346, 338 P.2d 803, 804.

7. "It is not without significance in the appeal that the judge, who heard the testimony and was in a position to observe the demeanor of the witnesses, not only declined to direct a verdict, but denied as well a motion for a new trial." Phoenix Blue Diamond Express v. Mendez, 9 Cir., 1939, 103 F.2d 66, 69.

8. "It is well established that the verdict must stand unless appellant can show there is no substantial evidence to support it considering the evidence in the light most favorable to appellees, and clothing it with all reasonable inferences to be deduced therefrom..." Gulf Oil Corporation v. Griffith, 5 Cir., 1964, 330 F.2d 729, 731.

In addition to the foregoing rules, it is submitted that, in deciding whether error had been committed in denying appellant DePinto's motion for a directed verdict, this court should give some weight to the fact that the ruling on that motion was made by the

same trial judge who had been reversed by this court for not having submitted the question concerning breach of fiduciary duty, as well as negligence, to a jury. DePinto v. Provident Security Life Insurance Company, 323 F.2d 826.

c.

Appellants Have Not Attempted To Show That The Jury's Verdict Is Not Supported By Any Substantial Evidence.

The evidence of record, briefly summarized in appellees' statement of facts, supra, is more than sufficient to support the jury's verdict. That is most likely the reason why appellants have not attempted to show, as they must in order to prevail herein, that there is no substantial evidence to support the jury verdict.

Instead of attempting to show that there is no substantial evidence in the record to support the jury verdict, appellants simply make the statement of preference and conclusion that "the verdict rendered in the lower Court has no support in the evidence" (Br. 27), and have then reasserted the argument advanced during the first appeal herein (No. 17114) in support of the request which DePinto then made that this court review the evidence and "consider the case de novo".[7] In electing to stand on that original argument, appellants have overlooked the

7. Opening Brief of Appellant DePinto, No. 17114, at p. 35.

effect of a jury verdict and the foregoing rules governing the review of a jury verdict.

d.

The Issue Of Proximate Cause Was Not One Of Law But Of Fact For The Jury.

Appellants' contention that DePinto was entitled to a directed verdict at the close of the evidence disregards the well-established rule that where the evidence on material facts is conflicting, or where on undisputed facts reasonable men may differ as to the inferences and conclusions to be drawn from the evidence or where different conclusions might reasonably be reached by different minds, the question is not one of law but of fact for the jury. Gunning v. Cooley, 1930, 281 U.S. 90, 94; Wong v. Swier, 9 Cir., 1959, 267 F.2d 749, 752; Figueroa v. Majors, 1959, 85 Ariz. 345, 346, 338 P.2d 803, 804; Golfinos v. Southern Pacific Company, 1959, 86 Ariz. 315, 345 P.2d 780, 781.

Thus, even if it is assumed for argument's sake, that, as contended by appellants, the facts are "undisputed", the issue of proximate cause did not become a question of law; it was properly submitted by the trial judge to the jury for determination because on such "undisputed" facts it was possible that reasonable men might differ as to the inferences and conclusions they would draw from such

evidence respecting proximate cause, and it was possible that different conclusions might reasonably be reached by different minds respecting proximate cause. Surely when Judge Boldt submitted the issue of proximate cause to the jury, he was giving DePinto the benefit of any and all doubt respecting that issue in view of the evidence here.

The issue of proximate cause was properly submitted to the jury, and therefore Point 1 of appellants' brief in regard to the claimed lack of proximate cause is without merit. It was an issue for the jury, and not for the parties on appeal.

e.

Appellants Have Conceded That The Verdict Is Supported By Evidence With Respect To Whether Several Of The Claimed Acts Of Negligence And Breach Of Fiduciary Duty Proximately Caused Loss To United.

As shown earlier under the designation General Response To Appellants' Arguments About Liability, DePinto has directed argument with respect to whether the jury verdict is supported by any substantial evidence only to one of the eight acts or claims of negligence and breach of fiduciary duty which were submitted to the jury - his negligence in electing the Niesz group to United's board of directors. Therefore, with respect to the other acts and

breaches of fiduciary duty, appellants have conceded that there is substantial evidence to support the verdict. In view of the evidence, undisputed by DePinto at any time during the last eight years, with regard to Kelly's negligence and misconduct and DePinto's delegation of his duties to Kelly, it is apparent why DePinto has not bothered to argue with respect to the other acts of negligence.

f.

Assuming The Only Issue Were Whether DePinto's Negligent Act In Electing Outsiders To United's Board Was A Proximate Cause Of United's Loss Of $314,794.19, Appellants Were Not Entitled To A Directed Verdict On The Issue Of Whether Such Transfer Of Control Was A Proximate Cause Of Loss.

The substance of appellants' position in seeking a directed verdict is that, as a matter of law, there can be no causal connection between DePinto's negligent transfer of control to the Niesz group and the loss to United. They appear, at page 17, to concede that DePinto was negligent, but at page 23 seem to argue that there could be no negligence because there is no duty to determine what the outsiders propose to do with the corporation once they obtain control. Assuming first that they have conceded negligence in regard to the transfer of control, the question is whether appellants'

view of the law is correct and whether they have applied law to undisputed facts or merely facts they contend are undisputed.

The key "fact" upon which DePinto's legal argument is based, is that he resigned prior to the time when the corporate resolution was adopted at the 4:15 p.m. directors' meeting of United. Upon that platform, he then constructs his entire argument that he can only be held vicariously liable for what the Niesz group did, and that there can be no proximate cause shown between his act of transferring control and their act of adopting a resolution taking United's assets. However, it is only DePinto's view that it is "undisputed" that he resigned prior to the time when the resolution was adopted at the 4:15 p.m. meeting of United's board on October 18, 1957. As shown more fully in Point 4 herein, infra, this contention is based on DePinto's theory that he resigned before the said resolution transferring assets was adopted because the paragraph preceding such resolution refers to the acceptance of his resignation. It was stipulated that DePinto resigned "about 4:15 p.m.", but there was no stipulation that he resigned prior to the time when the resolution transferring assets was adopted. The reason, of course, was that the 4:15 p.m. minutes were unsigned by anyone. (Exh. 5-H). Also, since DePinto testified in response to a question from his own counsel that he did not sign the 4:00 p.m. minutes of October 18, 1957 until October 19, 1957, the question of when the respective

resolutions were actually adopted was an open one. A jury is not required to accept DePinto's version of how the unsigned minutes of 4:15 p.m. must be interpreted. He has not shown any evidence that compelled the jury to find that he had resigned a second or two before the resolution transferring the assets was adopted, assuming they even thought it was significant in view of some of the other issues of negligence which were before them.

Assuming however for the sake of argument that DePinto's resignation was accepted a second or two before the Board of Directors's adoption of the resolution transferring assets occurred, the case law cited by appellants does not sustain his contention that there cannot in such a case be proximate cause as a matter of law between his prior act of turning over control to outsiders and the taking of assets by such outsiders. If that were true, then as a matter of law, there could not be liability imposed on those who negligently transfer control to outsiders who loot a corporation after resignations have been accepted from the transferors.

First, Insuranshares Corporation v. Northern Fiscal Corp., 35 F. Supp 22, certainly held that there was no proximate cause problem between the act of transferring control and the subsequent acts of the outsiders in looting a corporation. The court ruled that:

> " ... the owners of control are under a duty not to transfer it to outsiders if the circumstances surrounding the proposed

transfer are such as to awaken suspicion and put a reasonable man on his guard - unless a reasonably adequate investigation discloses such facts as would convince a reasonable person that no fraud is intended or likely to result. Thus, whatever the extent of the primary duty may be, circumstances may be sufficient to call into being the duty of active vigilance and inquiry. If, after such investigation, the sellers are deceived by false representation, there might not be liability, but if the circumstances put the seller on notice and if no adequate investigation is made and harm follows, then liability also follows."

Appellants' next case, at page 17, Barnes v. Andrews, 298 F. 614, does not support his argument. The reason is that the causal relationship in issue therein was between the defendant director's errors in business judgment and the business failure of the corporation; had this been a case of an illegal loan, the court pointed out, it would be a fair inference that a protest would have stopped the loan and that the director's neglect caused the loss. Here the loss to United was not due to a business failure. Rather the loss of United was closer to a situation involving an illegal loan which Judge Hand in Barnes, supra, said presented a fair inference that a director's failure to do his full duty caused the loss.

Appellants' citation of Michelson v. Penny, 2 Cir., 1943, 135 F.2d 409, at page 22 of their brief, is equally devoid of support for their contention that there can be no proximate cause, as a matter of law, between the transfer of control and subsequent loss caused by the outsiders. The language quoted by appellants from the case pertains to causal relationship between a director's violation of a provision of the Banking Act requiring directors to own stock and the loss complained, which requires the application of the standard of strict liability. Appellants did not point out that in Michelson, supra, the court did find a causal relationship between Penney's nonfeasance (complete neglect of duty as a bank director) and the loss to the bank.

Neither Benson v. Braun, 1956, 155 N.Y.S. 2d 622, nor Angelus Securities Corp. v. Ball, 1937, 20 C.A. 2d 423, 67 P.2d 152, nor Pritchard v. Myers, 1938, 174 Md. 66, 197 A. 620, involved any issue of proximate cause. These cases are discussed at pages 80, 83, 84 and 91 of appellee's brief here in No. 17114. It should be noted that Angelus Securities, supra, actually held that directors can be held liable for the acts of other directors where they "were negligent in supervising the corporate business" or "were negligent in the appointment of the wrongdoers."

The Briggs v. Spaulding, 1891, 141 U.S. 132, case, cited at page 20 of appellants' brief, which like all of the cases cited by

them in support of the proximate cause contention, was not a jury case, and was based on a conclusion by the court that the factual evidence in the record did not establish the negligence of the directors. Appellants have conceded the decision did not turn on a finding or ruling of lack of proximate cause at page 21 of their brief.

The last case cited by appellants, at pages 18 and 19 of their brief, Minnis v. Sharpe, 1932, 203 N.C. 110, 164 S.E. 625, stated only that plaintiffs had failed to carry their burden of proof. There the director resigned in January of 1927 and the loss occurred after November 27, 1927. Thus, the case is hardly "directly in point" with the assumed facts submitted by appellants to the effect that DePinto resigned one or two seconds before the loss occurred. The case was based on an absence of evidence showing a causal connection. If appellants are suggesting that there must be actual proof of a causal relation, by their citation to Minnis, supra, between DePinto's negligence and the loss to United, they are in error. The rule is otherwise, as most recently reaffirmed in Robledo v. Kopp, 1966, 99 Ariz. 367, 409 P.2d 288, 291:

> " ... In Apache Railway Company v. Shumway, 62 Ariz. 359, 158 P.2d 142, 159 A.L.R. 857, we held:
>
> > ' * * * All that is required in negligence cases is for the plaintiff to present probative facts from

w hich negligence and the causal relation may be reasonably inferred.' "

The cases cited by appellant do not support the principle that, as a matter of law, there is no causal connection between the act of transferring control to outsiders and the subsequent loss to the corporation caused by the acts of such outsiders. The instructions which were given to the jury, and to which no exception was taken by DePinto, are also to the contrary. That instruction stated:

> " Resignation of a director will not relieve a director of liability for corporate loss or damage proximately caused or contributed to by the resignation itself when a director knows, or in the exercise of reasonable care should know, that the interests of the corporation will be endangered by the resignation or will result in transfer of control of the corporation to others who are intending to approve and put in effect corporate transactions which the resigning director knew, or in the exercise of reasonable care should have known, would result in loss or damage to the corporation." (R.T. 582).

Assuming that appellants have argued, at page 23 or elsewhere in Point 1 of their brief, that there can be no negligence, as a matter of law, where a director turns control over to outsiders,

the Insuranshares doctrine is to the contrary. So is the foregoing instruction to which DePinto did not object. The law is that where the circumstances are such as to put the transferor on notice and if no adequate investigation is made and harm follows, then liability follows. Here the jury was certainly entitled to conclude as they did. DePinto's friend Kelly was selling about 38% of the stock in a corporation having a deficit the day before the sale for the sum of about $325,000. DePinto, as a director, should have known that United was in a deficit condition, and therefore the circumstances were such that a reasonable man would have been put on notice. It is no answer for DePinto to say he did not know because that is to elevate nonfeasance as a defense to a negligence action founded on nonfeasance. Kelly and Croydon and a group of lawyers, as well as the outsiders, all knew before October 18, 1957 that United's assets were to be used to pay Kelly for his stock. The only man who did not know was DePinto who did absolutely nothing, and has used that nonfeasance as an answer to the charges of negligence and breach of fiduciary duty. The jury did not agree with him, and he is now foreclosed from arguing the evidence again.

The argument he makes that there is a presumption that the outsiders who took United's liquid assets had good reputations is irrelevant as shown in Point 2 hereof . If DePinto's arguments concerning the good reputations of those who robbed United of its

assets had vitality, the court in Insuranshares, supra, would not have said the investigation must disclose such facts as would convince a reasonable person that no fraud is intended or likely to result. Here any investigation of a sale for $325,000 of 38% of the stock of United, a corporation having a deficit the day before the sale, would put any reasonable director on notice.

Appellants' contention that, as a matter of law, there could be no proximate cause between the transfer by DePinto of control of United to outsiders and the acts of the latter causing loss to United, is without merit.

g.

There Is Evidence In The Record To Support The Jury's Verdict Respecting Damages.

Appellants contend, at page 24 of their brief, that there was no competent evidence that United's assets were worth $314,794.19. Not only does the foregoing Statement of Facts demonstrate that such a contention is unfounded, but the competency of the evidence admitted respecting such issue is irrelevant to the only question when deciding whether a trial court erred in denying a motion for a directed verdict - whether there is any evidence in the record to support the jury's verdict respecting damages. In considering that question it is assumed that all the evidence which was before the jury had been properly admitted. Flintkote Company v. Lysfjord, 9 Cir., 1957,

246 F.2d 368, 377; Salt River Water Users' Ass'n v. Berry, 1926, 31 Ariz. 51, 250 P. 356, 360. The competency of evidence is not at issue upon a motion for directed verdict or the review of the denial thereof for the reason that a motion for a directed verdict goes only to the sufficiency of the evidence and presupposes that all of the evidence admitted by the court was competent, relevant and material. City of Phoenix v. Brown, 1960, 88 Ariz. 60, 352 P.2d 754, 757; Salt River Water Users' Ass'n v. Berry, supra.

At pages 24 through 26 appellants claim that the evidence "discloses that such assets were not worth that amount." However, that statement is not an argument that there is no evidence to support the jury's verdict on damages. It is nothing more than arguing the evidence on the theory that this appeal is a trial de novo. Appellants are simply disagreeing with the conclusions drawn from the evidence by the jury, and that contention is not available to them on an appeal from the denial of a motion for a directed verdict. Thus, although their Specification of Error No. 1 states there was no evidence from which the jury's verdict could be sustained except through conjecture and speculation, they have submitted no argument that there is no evidence. Furthermore, as the Supreme Court of the United States held in Lavender v. Kurn, 1946, 327 U.S. 645, 652, in regard to directed verdicts: "It is no answer to say that the jury's verdict involved speculation and conjecture." The Supreme Court went on to say it is "only where there is a complete absence of probative facts

to support the conclusion reached reached does a reversible error appear." Consequently, appellants' assignment of error itself is deficient. Since that is so, and there has been no argument that there is no evidence to support the jury verdict on damages, the appellants' assignment of error with respect thereto should be dismissed.

Assuming arguendo that appellants had presented argument on the question of whether there was evidence to support the jury's verdict, or that the specification of error presents it adequately, the contention is incorrect. First, it wholly ignores the nature of such assets which were $166,498.66 of cash, $60,668.65 in mortgages, bonds and accrued interest, and $87,626.88 in a promissory note and accrued interest. (Appellants' Br. 54). Second, since few taxpayers ever pay more federal income tax than is necessary, it is significant that Kelly, after consulting with tax counsel, filed a federal income tax return reporting $308,000 of the assets (he did not receive the final $6,794.19 taken by American) as having a fair market value of $308,000. (See Statement of Facts). Third, the Insurance Department of Arizona valued them at the $308,000 after a three and a half month examination and audit. (See Statement of Facts). Fourth, the purchaser American reported its cost at $308,000 in its books and records. (See Statement of Facts). And fifth, DePinto stipulated to the $308,000 in assets in the pretrial order of March, 1960, made no reservation therein

that such amounts did not represent fair market value, and added therein that as to him there were no issues of any material fact. (O.T. 237, 238, 240-242, 261). Thus, it appears that DePinto's concern about the fair market value of cash in the amount of $166,498.66 and notes, mortgages and bonds for the remainder of the $314,794.19 are of recent vintage particularly in view of his failure to put any testimony evidence in the record to the effect that such assets were worth less than $314,794.19. Possibly his problem was that on the one hand he was attempting to pump value into the United stock in his vain effort to persuade someone that its value several months before October 18, 1957 was high while on the other hand he wanted to argue that the assets taken on October 18, 1957 were not worth $314,794.19. In any event, if he had evidence that the bonds, mortgages and notes were not worth $314,794.19 along with the $166,498.66 in cash, it would have been an easy matter to place such evidence before the jury. Instead he chose not to do so, and now wishes to reargue the case in the court of appeals.

DePinto's suggestion, at page 25 of his brief, that because the witness Hammett testified United was in a deficit condition due partly to the $86,000 promissory note which was not an admitted asset, it follows that United could not have been damaged to the extent of the full $314,794.19, is an erroneous and inaccurate contention. The fair market value of an asset and its status as an admitted asset

are not the same thing. A life insurance company could own an oil well worth $500,000, but it would not be an admitted asset because of insurance law. It would not follow that directors who took the oil well could successfully argue, as DePinto attempts, that the corporation was not damaged because it was not an admitted asset.

Appellants' contention that some of the assets had a value to Kelly they would have had to no one else is specious. Their value to someone else would depend on Kelly's ability (financial) to pay them. Clearly he would have been the first person to reduce their value assuming they are the kind of assets which DePinto now argues they are.

Also, appellants' argument that it would have been an utter impossibility for the jury to have arrived at the value of the American stock is wrong. The foregoing Statement of Facts shows the several bases upon which the jury could find there was no value to the American stock. As shown there, the Insurance Department audit, Croydon, and the books and records of American all show that the stock was without any value. Further, Croydon testified that the American stock would "probably not be worthless <u>if</u> those mortgages were in there." (R.T. 371). Since those mortgages were not in there, he testified the American stock had no value. He also testified that the United stock had no value after the $308,000 was taken from United. (R.T. 367, 373). Thus, the only value the American stock

could have, if any, had to be found in the other assets and liabilities. The books and records of American, in evidence here, along with the testimony of Croydon, show that the liabilities of American exceeded its assets. (R.T. 364-368, Exh. 52, 53). These facts, along with the sudden birth of American at 4:45 p.m. on October 17, 1957, the day before its stock was sold to United with nothing more in its coffers than the promise of $75,000 by Sabo, shows there was no value to the American stock, and that Croydon had good reason to give it no value on his federal income tax return.

How the appellants can say, in the face of the foregoing evidence, if they did so argue, that there is no evidence to support the jury's verdict with respect to damages, is a matter for the court to determine. It is true that the jury reached a conclusion different than the one the appellants are advancing here. But a divergence of views between the losing party and the jury which rendered a verdict against him does not support a conclusion that no reasonable man could infer from the evidence before the jury that the damages were $314,794.19. What appellants are doing, at pages 24 and 25 of their brief, is presenting argument on the evidence which they view to be most favorable to their position as if the matter of damages were now before the jury or here on a trial de novo. But the evidence of record to which they refer was before the jury, and it drew different inferences and conclusions. It is too late for appellants to argue the

evidence. They are required to show that there is no evidence to support the jury's verdict as to damages. They have not attempted to do so.

h.

The Seventh Amendment Prohibits The Entry Of A Directed Verdict Once A Common Law Issue Is Tried To A Jury And The Jury Returns A Verdict For Plaintiff.

This court held in DePinto v. Provident Security Life Insurance Company, 9 Cir., 1963, 323 F.2d 826, that in a stockholders' derivative action it is necessary, in order to determine whether parties are entitled to a Seventh Amendment jury trial, to ascertain whether any of the claims asserted on behalf of the corporation are of a kind which, if asserted by the corporation, would be cognizable in a suit at common law. The court then held that where, as here, a claim of breach of fiduciary duty is predicated on underlying conduct, such as negligence, which is actionable in a direct suit at common law, the issue of whether there has been such a breach is a jury question. Thus, the court ruled that this case involved a common law issue to be tried to a jury.

The Seventh Amendment states:

"No fact tried by a jury shall be otherwise re-examined in any court of the United States than according to the rules of the

common law."

According to Crim v. Handley, 94 U.S. 652, 657, once a common law issue was tried to a jury, the appellate court's jurisdiction was limited to finding of errors of law in the proceedings and the award of a venire facias de novo, or new trial. There was no provision at common law for dismissal of such a case once a jury had returned a verdict for a plaintiff.

Rule 50 (b), Federal Rules of Civil Procedure, cannot change or supersede the Seventh Amendment.

Therefore, an appellate court is without power to order the entry of a directed verdict on behalf of the appellants.

Conclusion Regarding Appellants' Appeal From The Denial Of Their Motion For A Directed Verdict.

For each and all of the foregoing reasons, the appellants are not entitled to have the district judge reversed for denying their motion for a directed verdict. They, in addition, should not receive consideration on an appeal therefrom having insisted for eight years that they were entitled to a jury trial and that the district court had no power to grant partial summary judgment because there were issues, including proximate cause, which had to be submitted to the jury. The trial judge was even told that this court had ordered him to submit it to a jury regardless of any motion for partial summary judgment or otherwise. He did. DePinto lost.

Appellants Are Not Entitled To A New Trial Since The Admissions Of Fact Contained In The Pretrial Order And Exhibits Were All Material To The Issues Of DePinto's Negligence And Breach Of Fiduciary Duty.

Appellant DePinto objected to the admission in evidence of certain of the stipulated facts set forth in the pretrial orders as well as certain exhibits whose competence had been conceded in the pretrial order. Before responding to the merits of such objections, it is noted that appellants have not complied with Rule 18 (d) of the Rules of this court which requires that: "... When the error alleged is to the admission or rejection of evidence the specification shall quote the grounds urged at the trial court and the full substance of the evidence admitted or rejected, and refer to the page number in the printed or typewritten transcript where the same may be found." Insofar as the application of this portion of Rule 18 (d) is concerned, this court, in Queen Insurance Company Of America v. Larson, 9 Cir., 1955, 225 F.2d 46, 50, said:

> "... This specification does not, as required by our Rule 18, quote the full substance of the testimony said to have been erroneously admitted. Hence we are not required to consider this specification..." (Underscoring supplied).

The rule applies also where the specification of error relates to the

rejection of evidence. See Matsuo Yoshida v. Liberty Mutual Insurance Co., 9 Cir., 1957, 240 F.2d 824, 829, wherein this court stated:

> " ... appellants are precluded from raising the issue because of their failure to set forth the full substance of the rejected evidence in their appeal brief, as required by Rule 18, subd. 2 (d) of this Court ..."

See further, Tatum v. Tatum, 9 Cir., 1957, 241 F.2d 401, 406; Elkins v. United States, 9 Cir., 1959, 266 F.2d 588, 595; and Naval v. United States, 9 Cir., 1960, 278 F.2d 611, 614.

Appellants have not quoted the full substance of the admitted or rejected evidence to which their specifications of error and points 2 and 3 of their opening brief are directed. Nor have they otherwise stated the "full substance" of such admitted or rejected evidence. Appellants' paraphrasing of such evidence in each instance contains significant omissions. Compare for example the appellants' statement of the "full substance" of Mr. Tompane's testimony (appellants' Brief, Appendix, pp. 15-16) with the testimony of Tompane submitted on an offer of proof. (R.T. 393-408). When that testimony is read, it is seen that appellants' statement is extremely misleading since Mr. Tompane actually testified he had never told anyone that he had a commitment for mortgages or any other securities, and that without such mortgages, the "plan" could not be consummated.(R.T. 407)

What appellants have done here, as they have throughout their brief, is argue the evidence most favorable to their position just as though this were not an appeal from a jury verdict and as if they were entitled here to a trial de novo.

The court is not required to consider appellants' specifications of error respecting the admission of evidence or the rejection of evidence because they have failed to comply with the provisions of Rule 18 (d) of this court's rules. However, should the court consider the specifications of error concerning admission of evidence, the following is offered for the court's consideration.

The objections of appellants to the admission of certain evidence stipulated as fact and contained in exhibits whose competency was conceded, with the exception of their objections concerning damages, is premised on their view of the case to the effect that "the only issue in this case was the question of whether or not the transfer of assets from United to American on October 18, 1957 was proximately caused by the negligence of DePinto in participating in the election of the Niesz group to the Board of Directors of United." (Br. 28). This is consistent with their view that none other of the many acts of negligence and breach of fiduciary duty set forth in the pretrial order and given to the jury in the trial court's instructions were proper issues in this case. Thus, they contend that the evidence of DePinto's continuing negligence over a period of years, the delegation of his

duties to Kelly during the entire period of his directorship in United, his role with Kelly as one of the promoters of Life Underwriters, Inc. showing his long association with Kelly, his failure to perform any of his duties as a director for several years, his signature to minutes without reading them, his signature to minutes stating he was there when he was not, his lack of knowledge of who the corporate officers were for fifteen months before the loss of October 18, 1957 occured, all of which showed the conditions under which Kelly was able to arrange with impunity for the transaction of October 18, 1957 without fear of detection or objection by DePinto, are prejudicial to him before the jury. However, the only issue in the case was not, as appellants wish, whether DePinto was liable for the one act of negligence which they focus on. The claims of negligent conduct and breach of fiduciary duty proximately causing the loss of October 18, 1957 were fully set forth in the pretrial order, and many of such claims were presented to the jury by the district court. (T.R. 141-146, 151-156, R.T. 570-571). DePinto has actually conceded that such objections have no validity because he did not assign as error the ruling of the trial court, which he originally objected to, that the pleadings pass out of the case with the entry of the pretrial order. He is making an indirect attack on that ruling despite the considerable body of procedural law which refutes his theory that the pleadings must be narrowly construed and

any variance therefrom is prejudice to him even though he has been on notice of the specific acts of negligence since 1960 when the case was first tried, when he rests his objections to certain evidence on the theory that the only issue in the case is as he sees it. DePinto is basing his appeal here on a theory of pleading which has not been accepted by the federal courts since before the federal rules were adopted in 1938. Appellants'quarrel here is not with the jury verdict based on the several claims of negligence and breach of fiduciary duty but with the Federal Rules of Civil Procedure and the philosophy of modern notice pleading rather than nice pleading.

The evidence which appellants object to is relevant and material to several of the claims made against him which were submitted to the jury.Their suggestion that it was not is somewhat like arguing that the failure of a bank president to lock the vault night after night for two years is not relevant to the issue of his negligence in leaving the vault open on the night when an employee finally yields to temptation and empties the contents of the vault. Such evidence was relevant and material to the issues of whether DePinto breached his fiduciary duty and was negligent and whether such breach or negligence was the proximate cause of financial loss to United. It is merely DePinto's opinion that his derelictions of duty for two years prior to and including October 18, 1957 were not related or material to the looting by Kelly and American on

October 18, 1957. The ruling that such evidence was relevant and material is correct. Appellants' objection that such evidence may have prejudiced DePinto is beside the point. The prejudice resulted from the facts themselves, and when facts are relevant and material the fact that a defendant may be prejudiced by them is not a ground upon which they can be rejected. A defendant must show the evidence is neither material or relevant. Prejudice is not enough.

With respect to appellants' objections as to certain evidence concerning damages, it is noted first that they contend that the page from the report of the Insurance Department of the state of Arizona was inadmissable as hearsay. The said page of the report was admissable under the exception to the hearsay rule provided by the Federal Business Records Act, 28 U.S.C.A. § 1732, enacted in 1958. LaPorte v. United States, 9 Cir., 1962, 300 F. 2d 878, 880; Wilson v. United States, 8 Cir., 1965, 352 F.2d 889, 890; United States v. Re, 2 Cir., 1964, 336 F.2d 306, 313; United States v. New York Foreign Trade Zone Operators, 2 Cir., 1962, 304 F.2d 792. The second paragraph of section 1732 expressly provides that any lack of personal knowledge on the part of the maker may be shown to affect the weight to be given to the report "but such circumstances shall not affect its admissability", and thus refutes appellants' argument based upon the language cited by him from Olender v. United v. United States, 9 Cir., 1954, 210 F.2d 795. Furthermore, even

the basis of appellants' objection is invalid. The recording official who made and prepared the report is the same man who conducted the examination and audit, who looked at the books and records which served as much of the basis of his report (in evidence here), and who did not glean his information second hand. (R.T. 252-267).

Appellants further contend that with respect to the federal income tax return of Kelly for the year 1957, Exhibit 83, and the testimony of Kelly with respect thereto, that DePinto was unable to cross-examine Kelly and the income tax return was hearsay. However, Kelly was cross-examined at great length,at the trial when the exhibit was admitted into evidence,by DePinto. (O.T. 480-517, 556, 557). Kelly was examined at great length with respect to the relevant portions of the said return showing he had reported the assets received from United by way of American at the $308,000. (O.T. 456-462). DePinto had a full opportunity to cross-examine Kelly with respect to both the return itself and his testimony relating thereto. Now that he was not available and his testimony was offered by DePinto on such ground at the last trial in June of 1965, appellants cannot complain when it is not possible to cross-examine him. His testimony was offered by DePinto at the trial, and he must live with the fact that he was not available in 1965 for cross-examination. The return is of course not hearsay since it was admitted after testimony from the man who filed the return and signed it. It is

also noted for the court that the tax attorney who prepared the return of Kelly, Mr. Frank Campbell, maintains a law office less than a block from the courtroom in which this case was tried. Furthermore, appellants' characterization of Exhibit 83 as being "incompetent" is suprising and unwarranted since (1) it is a certified copy of the original return provided by the District Director of Internal Revenue in Phoenix, Arizona with whom it was filed, and (2) such a characterization contradicts DePinto's stipulation in the pretrial order regarding the authenticity of the exhibit. (T.R. 92, 97).

Similarly it is difficult to understand the basis of appellants' statement, at page 30 of their brief, that Hammett's testimony respecting the financial condition of United on October 17, 1957 and December 31, 1957, and the effect of the October 18, 1957 transaction, was "hearsay and not supported by a proper foundation". It was established, through Hammett's prior recorded testimony, that Hammett was a Senior Examiner of the Insurance Department of the State of Arizona (R.T. 261), that he had conducted two prior examinations of United (R.T. 257), that he and an assistant had conducted the examination over a three and a half month period working eight hours a day for five days of each week (R.T. 258), that he had examined United's books and records (all of which in themselves constituted entries made in the regular course of business

and thus fall outside the hearsay rule) and made an official report thereon containing the necessary or incidental statements of financial condition (R.T. 257-259). Since Hammett's report itself is admissable under the exception to the hearsay rule provided by 28 U.S.C.A. § 1732, his testimony respecting its preparation and the contents of the report is equally admissable particularly since such testimony was originally subject to cross-examination by DePinto. (O.T. 1059-1081, 1083). Also, such objections now are extremely surprising since they were not made at the trial, and are made after it was agreed by DePinto's counsel that because Mr. Hammett, who was in court and under subpoena by appellee, was suffering from terminal cancer, he could therefore, for purposes of the trial below, be considered as beyond the reach of process. (R.T. 247, 251).

Finally, the argument presented by appellants in the middle of page 30 of their brief concerning what the value of the $308,000 in assets should be is not related to the question at hand of whether or not Kelly's return was admissable. Instead appellants are again arguing the evidence most favorable to their position just as if there were no jury verdict and they were here on a trial de novo. The argument is one which DePinto could have made and may have made to the jury, but it does not bear on the issue of whether the return was admissable.

For the foregoing reasons appellants are not entitled to a new trial on the ground that evidence was erroneously admitted by the district judge.

3.

Appellants Are Not Entitled To A New Trial Since The Evidence Rejected Was Neither Relevant Nor Material To Any Of The Issues In The Instant Case.

As noted in Point 2 herein the court is not required to consider appellants' specifications of error regarding the rejection of evidence because of their failure to comply with Rule 18 (d). Should the court, however, consider such specifications, it is submitted that each is without merit.

The rejected evidence to which the specifications of error are directed, whether it took the form of testimony, admission of fact, or exhibits, falls into several general categories. They are: (a) the "plan" respecting the procurement of mortgages for either American or United, (b) the "reputation" of the Niesz group (the looters) for integrity, (c) the attempted but unsuccessful prior effort to sell Kelly's stock to Insurance Corporation of America, and (d) the "investment" by Dr. Sabo in American. The following response will be to each of the categories rather than to each specific item.

The "plan", which allegedly envisioned a gift by some owner of

mortgages to American, was finally and forever shown to be nothing but a figment of DePinto's imagination when the trial court questioned Mr. Tompane. (R.T. 363, 407-408). On the offer of proof by DePinto, Tompane, the person who was said to have stated he would supply mortgages to American, testified that an essential element of the "plan" was the existence of the mortgages, and that he had never told anyone prior to October 18, 1957 that he had a commitment from anyone for the mortgages necessary for such a "plan." (R.T. 407-408). Furthermore, DePinto placed into evidence testimony of Croydon that the persons who, he claimed, would put mortgages into American, would take stock back for such mortgages, and thus there would not be any gift to the capital structure of American. (R.T. 372). Further, how would or could mortgages put into American, for which the transferors would receive stock in American, replace the $314,794.19 in assets of United which had been taken by American and Kelly on October 18, 1957? The "plan", according to Tompane, was non-existent, but even if it had existed would not have repaired the damage to United. As the trial court found, in its Supplemental Finding of Fact No. 30 in 1962:

> " Not only is it inherently improbable that anyone would contribute $314,794.19 gratis to United, but the testimony of Croydon, who was claimed to have authored the plan, was that such mortgages would never get to United Security Life.

" ... Assuming that some individual or corporation could have been induced to give $314,794.19 in mortgages to United or even to American, it would still be grossly negligent for those having a fiduciary duty to United to permit or cause the $314,794.19 transfer until other assets were in hand." (O.T. 1730-1731).

In short, DePinto claims the district judge should be reversed for rejecting evidence concerning a "plan" which was never carried out, which never existed except in the minds of looters who were looking for excuses after having been caught, which was denied by the person who was said to have committed such mortgages, which would not have repaired the $314,794.19 loss to United on October 18, 1957, and about which the appellant DePinto knew nothing at or prior to the loss on October 18, 1957. Such evidence is neither relevant nor material to the issues of whether DePinto delegated all of his duties to Kelly and is therefore responsible for Kelly's negligence, whether DePinto failed to require measures for the protection of United on and before the October 18, 1957 transaction, whether DePinto failed to exercise reasonable care to assure that adequate funds be obtained for United in exchange for its transfer of its cash and other liquid assets, whether DePinto failed to keep himself advised as to the important transaction of October 18, 1957, and whether DePinto's failure to discharge his

duties as a director for two years prior to October 18, 1957 caused the conditions which permitted Kelly to rob United of its assets. The relevance which DePinto urges is based on his theory that the only issue he was required to defend was whether DePinto negligently elected the Niesz group to United's board of directors, and the further contention that these men of integrity were simply engaged in a "plan". In states such as New York and California, these men of integrity would have been indicted and prosecuted for their "plan", and it would never have occurred to DePinto that he should urge such a "plan" upon a jury in a civil case as a defense to negligence and breach of fiduciary duty on his part.

Actually the evidence respecting the "plan" takes on an Alice in Wonderland aura when it is viewed from a distance. Yet this is what DePinto claimed was material and relevant. The heart of this argument by DePinto and several others in this appeal is that his sole duty as a director of United with respect to the loss of October 18, 1957 was to either conduct an investigation of the reputation and plan of each of the Niesz group or show that, had he conducted an investigation, he would have found they had a "plan." The fact is that had he conducted an investigation of the plan, he would have found that under the "plan", United was going to lose $314,794.19. What he wanted to do at the trial court was defend one lawsuit whereas

plaintiff, the district court, the jury, and the pretrial order were all involved in trying a different lawsuit. DePinto asks for a reversal and new trial so he can defend the lawsuit he would have prosecuted had his efforts to do so succeeded when he prepared the complaint for Provident which was rejected as not being bona fide by the trial court. Now that he has failed in the latter attempt to control the conduct of and extent of plaintiff's case against him, he is now appealing for the same result by shifting the level of his arguments to those of the days of nice pleading in the courts.

The argument appellants made at pages 34 and 35 of their brief with regard to the rejected evidence concerning the "reputation" of the outsiders who took United's assets demonstrates the irrelevancy and immateriality of such evidence. It is contended there that if DePinto had made an investigation of all of the facts and circumstances surrounding the transaction of October 18, 1957, he would presumably have learned of those facts and circumstances (the rejected evidence) which, he contends, discloses "that the Niesz group did not loot United and had no intention of looting it." By limiting his argument to the rejected evidence, DePinto has thus excluded the evidence of record which shows that the Niesz group did loot United openly, brazenly and intentionally. None of the rejected evidence can overcome the established fact that they did loot United. Nor can the rejected testimony overcome the fact that their intention, as manifested in

the evidence of record, was to loot United. See e.g. Exhibit 58 (Agreement with Kelly), Exhibit 5-H (Minutes of United), Exhibit 50-N (Minutes of American), and the testimony of both Kelly and Croydon that each knew several days before October 18, 1957 that the $308,000 in assets of United were to be used to pay Kelly for his stock in United (R.T. 331, 382), as well as the testimony of Croydon that merely putting the American stock into United could not satisfy the Insurance Department, and that no mortgages or other assets were ever placed in United to take the place of the assets removed on October 18, 1957 to pay Kelly. (R.T. 382). Also, Tompane's testimony that he never committed any mortgages to such group before or on October 18, 1957 provided evidence of the intention to rob United of its assets. (R.T. 407-408). However, even if the rejected evidence could somehow overcome the above evidence of record which shows the intention of the Niesz group, DePinto has not shown that such intention is relevant or material to any issue in this case. What he proposes to prove thereby is the "good faith" of those who took United's assets. But there is no issue of fraud either with respect to DePinto or those who took the assets. Thus, even if this case were viewed as one which involved, as DePinto contends, only the issue of his "vicarious liability" for the acts of the Niesz group, the "good faith" of such group would be irrelevant and immaterial. In short, under DePinto's vicarious liability theory,

the test is whether the Niesz group would be entitled to defend the charges of negligence and breach of fiduciary duty causing loss to United on the ground that they acted in "good faith". Since it could not, it is not available to DePinto even if the basis of his liability here were, as he claims, the concept of vicarious liability.

DePinto's liability here stems from his own acts of negligence as set forth in the pleadings and then in the pretrial order and then in the instructions to the jury. Thus, the good faith of those who took the assets, assuming they could be found to have acted in good faith, is not a defense to his acts of negligence. DePinto has not established the materiality or relevancy of such rejected evidence to the issues respecting his own negligence.

The district court also properly refused to admit the testimony of Kelly concerning what he was asking for his stock several months before he finally raided United's assets. Since the attempted sale to the Insurance Corporation of America was never consummated testimony with regard thereto is in no way probative of the fair market value of Kelly's stock in United at any point in time let alone on October 18, 1957, assuming the value of such stock, prior to the transfer of $314,794.19 on October 18, 1957, would have any bearing at all on the value of the American stock after the $314,794.19 was taken.

The exclusion of testimony that Sabo was to make an investment

of $115,000 in American, referred to at page 36 of appellants' brief under the subtitle "Evidence As To Damages", was properly rejected because such evidence was not offered to prove the value of American stock or otherwise directed to the damages issue. DePinto told the trial court that: "this testimony goes to the matter of good faith on the part of these directors." (R.T. 356, 357). When, at a later point in the trial, an offer of the same evidence was made, the trial court asked DePinto if he wished to enlarge the purposes for which it was offered, but DePinto failed to add any further reasons why it was offered. (R.T. 541-5, 541-6, 541-7). Furthermore, a reading of DePinto's argument in the third sentence of the second paragraph at page 30 shows that he studiously avoids any statement that such evidence was offered on the issue of damages. He is asking that the district judge be reversed for not having ruled on the proffered evidence as admissable on the damages issue when he (DePinto) offered it to prove the good faith of the Niesz group.

Appellants also object to the rejection of admitted fact No. 188 stating that $52,000 was sent to American by Sabo on October 18, 1957. First, there is nothing in the record to show why this fact was offered. (R.T. 520). However, since the $52,000 was part of the above $115,000 (Br. App. p. 15) and the $115,000 was offered to prove the good faith of the Niesz group, presumably it was

offered to prove good faith, and was therefore just as irrelevant as the $115,000 item. Furthermore, the evidence of record (Exh. 52 and 53) already showed that Sabo had transferred the $52,000 to American on October 18, 1957. The court below ruled that such ledgers could be shown to the jury or sent in if desired. (R.T. 604). Therefore, DePinto was not prejudiced even if the court below had erroneously rejected the testimony concerning the $52,000 from the prior recorded testimony. Next, standing by itself, the $52,000 transfer of funds from Sabo to American proves nothing insofar as the value of American stock is concerned. (R.T. 492).

Next, at page 36, appellants object to the rejection of testimony of Croydon which they characterize as "bearing on the value of United stock." A reading of such testimony shows that it does not prove or tend to prove the value of the loss realized by United when its assets were taken or the value of the American stock. What has the value of the United stock, prior to the loss of its assets, got to do with the value of the American stock? Clearly such proffered testimony was neither material nor relevant. The only testimony which could be deemed relevant or material, if anything could, would be the value of the United stock after the loss on October 18, 1959, and on that count DePinto's own witness Mr. Croydon testified:

"Q. Now, I understand you to say that at the end of

October 18, 1957, the 38,000 shares of United Security Life stock would have no value?

A. Without the mortgages, they would have no value.

"THE COURT: You didn't have them on that day, did you, at the end?

THE WITNESS: No, sir. " (R.T. 373).

In light of this testimony by Mr. Croydon, DePinto could not put on evidence through the same witness which would impeach him or attempt to show value when his witness testified there was none.

The offer of the Hammett testimony regarding value of United stock was properly excluded because it violated the previous ruling that all of a witness' testimony should come in at one time in order not to confuse the jury (R.T. 265, 267, 273, 544), did not prove any issue in the case, and was testimony of a witness which DePinto objected to himself. (R.T. 544-545). Also, what is the relationship between the value of the United stock, prior to or after October 18, 1957, and the value of the assets lost by United or the value of the American stock? It is no defense for a director of General Motors, who permits its assets to be transferred to a newly formed corporation negligently, after which the assets are distributed to 38% of General Motors' stockholders, to contend that the damage must be reduced by the value of the General Motors stock turned over to the new corporation by such shareholders in exchange for the assets. Minority shareholders

have not been permitted to do such a thing in this country for nearly three quarters of a century, and the cases have stopped talking about the matter since the rule is so well recognized. The only entity entitled to a corporation's assets, until two-thirds of the shareholders have approved a liquidation, is the corporation itself. If a liquidation is voted, the creditors and policyholders must be paid first, and, if there is anything left, it goes to the shareholders. No minority shareholder group can defeat this rule by doing it anyway and then arguing that the damages against them must be reduced by the value of their stock. They can have their stock back after they replace the cash and corporate assets,as the directors liable for United's loss are welcome to the 38% of the United stock(which appellants say had value even though all of United's assets were taken from it), but not a reduction in the recovery against them.

The district court also properly excluded the testimony of Gregory saying that Provident had obtained loans in 1959 and issued certificates of contribution therefor. (R.T. 529). How could a loan to a successor life insurance corporation, several years after 1957, prove anything other than that the outsiders had a "plan" to borrow money to replace the lost assets? If the evidence of such a nature relates to the damages sustained by United in 1957, the district court was unable to find it.

The District Court Did Not Err In Its Instructions To The Jury.

Again the appellants' contention respecting alleged error in the giving of instructions to the jury follows from their view that the only issue is as they see it on the theory that the complaint in intervention may only be looked to,and must be narrowly construed, and is controlling over the pretrial order rather than vice versa. That is, they are again attacking the validity of the pretrial order, the notice concept of pleading, and the Federal Rules of Civil Procedure without having assigned as error the ruling of the district court with respect to the pleadings passing out of the case.

The instructions which appellants object to at page 37 of their brief were warranted by reason of plaintiff's contentions in the pretrial order which presented a series of acts of negligence and breach of fiduciary duty and the superseding of the pleadings by that pretrial order. Based on the three issues presented to the jury in the form of questions concerning negligence, proximate cause, and the amount of damages, plaintiff was entitled to have the jury instructed as to the several acts of negligence as well as the several acts of breach of fiduciary duty which he claimed proximately caused the loss of October 18, 1957, and the jury was entitled to determine whether any of such acts or all of them were the proximate cause or causes

of the October 18, 1957 loss. DePinto did not have the right to have a corporation's claims of breach of fiduciary duty and negligence tried as though there were only one single act of negligence or breach of fiduciary duty when the plaintiff had set forth numerous such acts. It is appellants' opinion only that those claimed acts of negligence and breach of fiduciary duty, other than the act of electing the looters to the board, cannot be heard by the jury. There is no procedural or substantive law which agrees with them, and they have cited none. There is not a case citation found in their argument on evidence admitted or rejected. The reason is that all of those arguments rest on their assumption that the only case DePinto was required to defend was the case he preferred to defend. And the reason DePinto adopted such an assumption was that he had no defense to the other acts of negligence and breach of fiduciary duty in view of the facts which he had admitted prior to the preparation of the pretrial order in response to requests for admissions of fact. That is, appellants' theory of the case is required because of the undisputed facts which were contained in the pretrial order and read to the jury. The thrust of their argument here is that instructions concerning many of those facts read to the jury were improper because they do not coincide with their view of plaintiff's case. What they are attempting to do is control the presentation of plaintiff's claims indirectly without having directly assigned as

error the setting forth of plaintiff's claims in detail in the pretrial order and the district court's ruling that the pleadings passed out of the case upon entry thereof. DePinto is not living with that order here, and yet he has not appealed from it. Worst of all much of his premise rests upon an argument from the evidence that "there was no evidence introduced to support the allegation of Count VI," a count in one of the pleadings which passed out of the case upon the entry of the pretrial order. Does DePinto know that the jury agreed with him? Furthermore, his argument rests on his interpretation of Count VI's words "caused" and "permitted". He says none of the evidence shows DePinto breached his fiduciary duty by causing or permitting the transfer of United's assets on October 18, 1957. The evidence shows that his breach of fiduciary duty in several respects did cause such assets to be transferred, and did permit such transfer.

All of page 38 of appellants' brief is a reiteration of the same arguments that the instructions misstated plaintiff's claims to the jury because such claims are limited to a pleading (the complaint in intervention only) which pleading must be narrowly interpreted as DePinto reads it.

Appellants contend at page 39 of their brief that the instruction set forth therein "is highly prejudicial to defendant for the reason that there is not a scintilla of evidence that he <u>knew</u> that the Niesz group intended to perpetrate an illegal transaction, nor is there any

evidence whatever to support the conclusion that he was aware of any suspicious circumstances which would have required an investigation on his part." However, appellants overlook the entire language of the instruction that a director cannot remain silent and inactive when "in the exercise of reasonable care by him, he should know, that an illegal transaction, or one potentially harmful to the corporation is being attempted by officers or other directors of the corporation." In that light the instruction was proper.

Appellants' objections to the instruction concerning the liability of a director who delegates his duties to another stems also from his view that such was not an issue here. The suggestion that such instruction was an attempt to hold him liable for the acts of the Niesz group is incorrect. The record shows DePinto delegated his duties to his friend Kelly and was no more than a figurehead or dummy director, and is therefore liable for the negligence and misconduct of Kelly about which there is no dispute.

The appellants' objections, at page 41, are directed to the instruction respecting when a resignation of a director becomes effective, and are based on his view of the evidence that there was no issue with regard to whether such resignation was effective prior to the adoption of the resolution transferring United's assets on October 18, 1957. As shown herein, and in the Statement of Facts, there was a serious question in that regard. It was therefore proper to instruct

that: "A resignation specified therein to take effect upon acceptance does not become effective until it is accepted." Had the jury not been so instructed, they might have concluded from the document that DePinto's resignation occured on October 17, 1957 whereas it was stipulated that DePinto's resignation was accepted October 18 "about 4:15 p.m." (R.T. 518). There was no stipulation, as appellants appear to argue, that DePinto's resignation was accepted prior to the time when the board of directors formally adopted the resolution respecting the transfer of United's assets to American. That is only appellants' conclusion based on the placement of the paragraphs in the unsigned 4:15 p.m. minutes of October 18, 1957. However, since they were unsigned, and DePinto testified that he did not sign the 4:00 p.m. minutes of October 18, 1957 until the following day, October 19, 1957, there was a question of fact before the jury as to when DePinto's resignation was accepted in relation to the transfer of United's assets to American. (R.T. 500).

Appellants' objection to the trial court's instruction respecting the responsibility of an absent director disregards the facts which make it applicable to DePinto. His objections are again based on his assumption that it is "undisputed" his resignation was accepted at the 4:15 p.m. meeting before the resolution was adopted transferring United's assets. Furthermore, DePinto was a director at the time of both the 4:00 p.m. and 4:15 p.m. meetings. Until his resignation at the 4:15 p.m. meeting, during the meeting, he was a director.

The Trial Court Did Not Err In Refusing To Give DePinto's Requested Instructions Numbered 4, 5 And 8.

The irrelevancy and immateriality of the background and reputation of each of the group who took United's assets on October 18, 1957 has already been set forth. DePinto's objections to the refusal of the district judge to give his fourth instruction is also dependent on that contention, and is therefore without merit. His instruction, as he admits, would "require the jury to conclude that the acts of the Niesz group (those who took United's assets) was a superseding cause of harm to United which relieved DePinto from responsibility." (Br. 43). Such an instruction is erroneous on the law, and would be erroneous on the facts since the jury was entitled to determine as a matter of fact whether DePinto resigned after or before the transfer of assets. The instruction does not permit the jury to find liability on any of the other bases given to them in the instructions and set forth in the pretrial order, and is therefore erroneous.

Nor did the district judge err in refusing to give that portion of his requested instruction No. 5 set forth at page 44 of his brief. First, the grounds relied on in attacking the refusal to so instruct are not the grounds which appellant DePinto urged at the trial. (R. T. 596). Second, the argument is without merit. The statement in

the requested instruction is a misstatement of law (see the material herein at Point 1 discussing Barnes v. Andrews, supra,). The instruction is not applicable to the facts of this case and is actually inconsistent with the law of proximate cause as the district court did instruct. The trial court not only properly instructed as to proximate cause but also as to the burden of proof in this case, and the requested instruction would be inconsistent with the law as given in those instructions.

Insofar as appellants' requested instruction No. 8 is concerned, appellants are again urging grounds in support of the alleged error regarding the instruction which were not urged before the trial court. (R.T. 596-597). When appellants say that "when the matter of proximate cause is explained to a jury, the party defendant is certainly entitled to have the matter explained to the jury as fully, completely and clearly as possible", they are overlooking the scope and length of the charge which was given regarding proximate cause. (R.T. 574-576). It may be that appellants' narrow view of what the issues are here permits him to believe that the language cited by him from Salt River Valley Water Users' Ass'n v. Cornum, 1936, 49 Ariz. 1, 63 P.2d 639, is applicable here, but in the light of the issues which were actually tried and presented to the jury, the instruction would have been confusing, misleading and wrong in view of the absence of the supervening cause upon which it is predicated.

Appellant DePinto's Counsel Had Notice Of And Approved The Answer To The Jury, Did Not Make Exception Thereto, And The Answer Was Not Prejudicial Being Merely An Amplification Of An Earlier Instruction To Which Appellant Did Not Object.

Of the several attacks which have been made by appellant DePinto on the integrity and fairness of the visiting district judge who heard the instant case, none has been more unfair or grossly misleading than the innuendo, implications, inference, and direct statements contained in the argument that the district court prejudiced appellant DePinto by the manner and substance of his answer to a communication from the jury. Because these attacks are endemic to appellant DePinto's conduct of his defense here, the court is earnestly asked to bear with the following full statement, in context, setting forth the facts concerning the currently objected to answer by the district judge.

Prior to retiring to consider its verdict, the jury was instructed that:

" The essential issues of the case are:

1. Is defendant DePinto chargeable with negligent breach of fiduciary duty in any one or more particulars asserted by

plaintiffs? If so,

2. Did such negligent breach of fiduciary duty of defendant DePinto proximately contribute to causing financial loss and damage to United Security Life, a corporation? If so,

3. What was the amount of such loss and damage to United Security Life?" (R.T. 571).

Later, after being instructed on the negligence and proximate cause aspects of the case, the district judge instructed the jury that:

" The claimed items and amounts of assets transferred to Kelly consist of cash by check or bank certificates of deposit in the sum of $166,498.66; second, promissory notes and accrued interest thereon, totaling $87,626.88, and third, mortgages, bonds, and accrued interest thereon in the amount of $60,668.65." (R.T. 587).

Within an hour and a quarter after the jury retired, it sent the following question to the district judge:

" If the jury find in favor of the Plaintiff, is Dr. DePinto responsible for the full amount or whatever the jury specifies? (T.R. 236,292).

Thereupon, the district judge consulted with and obtained the approval of counsel for appellant DePinto and for appellee to the following answer:

" The full amount of damages sustained as found by the jury." (T.R. 293).

At about 6:00 P.M., the jury sent the following communication to the district judge:

" 1. Jury wishes a repeat of the 3 factors to be used in judging for the plaintiffs. (Underscoring supplied)

2. The verdict lists the defendants as:

Provident Life Ins. Co., Angus J. DePinto, et al,

Our impression from the trial is that Dr. DePinto was the only defendant. Please clarify." (T.R. 237).

Thereafter, the answer which is now objected to by appellant DePinto was discussed by the district judge with Mr. Herbert Mallamo, counsel for appellant DePinto, and with counsel for appellee. The following was approved by both Mr. Mallamo and by counsel for appellee, and sent to the jury:

" Answering your first inquiry:

The three (3) ultimate issues are:

1) Was defendant DePinto negligent in performing his fiduciary duties in one or more of the particulars asserted by plaintiffs? If so,

2) Did such negligence of defendant DePinto proximately cause or contribute to causing loss or damage to United Security Life? If so,

3) What was the amount of such loss or damage?

The three items of claimed damage are:

1) Cash, by check or bank certificates of deposit - $166,498.66

2) Promissory notes and accrued interest thereon - 87,626.88

3) Mortgages, bonds and accrued interest thereon - 60,668.65

Total - $314,794.19

Answering your second inquiry:

There are other defendants in the case, but the present trial is concerned only with the liability of the defendant DePinto." (T.R. 238).

Subsequently, the jury deliberated for several hours before returning its verdict.

When the jury returned its verdict, Mr. Mallamo was present in court along with counsel for appellee, the district judge, and Mr. William Loveless, Clerk of the Court. Upon receipt of the jury's verdict, the district judge, in the presence of all counsel including Mr. Mallamo, orally ordered that the communications from the jury and responses, marked No. 1 and No. 2, be filed by the clerk and that the record show the responses were taken up with counsel and are proper, and that communication from the jury marked No. 3 be filed. (T.R. 293). Mr. Mallamo remained silent, and made no statement at all that appellant DePinto objected to or had objected to the response to the jury's second communication.

Later, and after July 6, 1965, when his Amended and Supplemental Motion for Judgment in Accordance With Motion for Directed

Verdict was filed, appellant DePinto's counsel filed a memorandum in support thereof, and which states at page 24 thereof:

> " The Court called defendant's attorney by telephone and advised him that he intended to answer the jury's note by informing them as to the three factors - negligence, proximate cause and damages, and he further intended to advise them of the three items of damage. The Court did not read to defendant's attorney the note which was transmitted to the jury. After considerable discussion and importuning by the Court, defendant's attorney indicated to the Court that it would be all right to mention the three factors - negligence, proximate cause and damages, and also the items of claimed damages."

Thus, appellant's counsel has conceded, after the event, that he told the district court it was all right to mention the three items of claimed damages.

Therefore, under the case cited by appellant DePinto, Fillippon v. Albion Vein Slate Co., 250 U.S. 76, the written supplemental instructions to the jury were proper. The reason is that Fillippon, supra, said that instructions to the jury are valid if sent after notice to counsel and an opportunity to object. Here Mr. Mallamo had both notice and an opportunity to object to the response at the time it was discussed with the district judge and again in open court. Instead he told the district judge it was all right to send a response mentioning

the three items of claimed damages to which appellant DePinto now objects.

The fact that no exception was taken to such response to the jury, standing by itself and ignoring the fact of appellant's approval of the response, is sufficient to strike down his request that the district judge be reversed on this issue. Macartney v. Compagnie Generale Transatlantique, 9 Cir., 1958, 253 F.2d 529, 525.

In any event the response complained of was not prejudicial. The district court had earlier instructed the jury as to the three items of claimed damages, and no exception was then taken by DePinto. Therefore, when the same instruction was again used to answer a question from the jury asking for a "repeat of the 3 factors to be used in judging for the plaintiffs" after first setting forth the essential issues of the case, the defendant was not prejudiced. If anyone was prejudiced it would have been plaintiff. Why? Because the jury did not ask for the three issues in the case which were given to them first in the response. They asked, after first having asked whether Dr. DePinto would be responsible for the full amount or whatever the jury specifies, for a repeat of the 3 factors to be used in judging for the plaintiff. However, plaintiff recognizes that the first part of the response was an effort by the district court to give an answer which did not favor either side, and that it was a noncommittal reply to a question or request which plaintiff thought indicated a clear

judgment in favor of plaintiff with the only question being: what are those three items of claimed damages about which you instructed us earlier? American Life Ins. Co. v. Florida Anglers Ass'n, 5 Cir., 1950, 185 F.2d 460, 463, stated:

> " ... If error was committed by the Court in answering a question for the jury in the absence of counsel for the defendants, it was error without injury, since the statement made was substantially a repitition of matter covered by the oral charge."

The request from the jury, the form and substance of the reply, the consultation with and approval from both counsel, all show that there could not have been error. If the answer was as bad as appellants now say, why did qualified counsel approve and tell the district judge the three items of damages could be mentioned in the response? Also, it could not have practically invited the jury to return a verdict since they later sent in a communication telling the court they were apparently deadlocked. (T.R. 239).

What appellants have done with this assignment of error is to try to stimulate the court into speculating unconsciously about what the jury did, whether another jury would do differently, how it reached its verdict, and so on. That is the only plausible explanation which can be given for the appellant having made the misstatements offered in support of his contention that he was

prejudiced by the response which he approved and did not take exception to at the time. That such speculation is his hope is shown by the final paragraph of such argument in which he says the verdict probably would not have been entered in the absence of such a response.

In light of the foregoing material, it is wrong for appellant to suggest to the court that the first time the jury ever heard of the three items of damage was in the said response. He does that by saying that "nowhere in the evidence is there any reference to the three items of claimed damages." Appellant knows, however, that those portions of the pretrial conference order setting forth the assets and amounts thereof which had been lost on October 18, 1957, which items were broken down into cash, promissory notes, and mortgages, bonds and accrued interest thereon all totaling $314,794.19, were read to the jury and later divided into three categories, as shown earlier, by the district court in its instructions to the jury. (R.T. 212-214, 587). It was also wrong for appellant to tell the court that the district court's response was taken up with his counsel, but not to go on and tell the court of his approval followed by a concession thereof. To leave the implication that there was a lack of communication between his counsel and the district under the foregoing circumstances is equally erroneous.

The district judge should not be reversed for the said response.

The Judgment Entered Herein Was Not Excessive.

Although this is a stockholders' derivative action in which the judgment rendered is in favor of the injured corporation or its successor, the trustee in bankruptcy is asking that the claim herein against the assets in the bankruptcy court be reduced from the $314,794.19 returned by the jury in a general verdict to $80,856. His argument is that 42,548 shares of United's stock have been cancelled, and therefore the judgment should be reduced by 42.5 % to $180,856. Then he says the $100,000 paid by the Duhame Estate, in settlement of separate claims of $177,863.84 for damages to United occurring prior to the date when it lost the $314,794.19, should then be applied to reduce the judgment further to the sum of $80,856. Thereafter, he contends that interest allowed from October 18, 1957 is erroneous. Thus, the trustee in bankruptcy says that the maximum claim the judgment creditor here can have against the bankrupts' assets is $80,856. If the trustee is right, then the approximately $725,112.03 of general creditors' claims, arising after the 1960 and 1962 judgments entered herein, would be satisfied from the bankrupts' assets of $754,109.44 whereas should the judgment be affirmed, the policyholders and stockholder beneficiaries thereof would recover if the judicial lien herein was not declared null and void. In the latter event, the recovery herein is about

thirty to thirty-five cents on the dollar assuming the assets produce the full $754,109.44.

Therefore, in balancing the equities while evaluating some of the equitable arguments which the trustee in bankruptcy makes here, the court is asked to weigh in its scales that commercial general creditors, including Massachusetts Mutual Life Insurance Company, who loaned nearly $700,000 to another creditor, Trosco Land, Inc., which is not likely to be recovered therefrom, are here in the person of the trustee in bankruptcy and others, attempting to collect those claims by reducing or eliminating the judgment rendered herein for the third time for the benefit of United's stockholders.

a.

The Cancellation Of 38,798 Shares Of United Stock In 1959 And The Surrender Of Certificates Of Contingent Interest From 3750 Shares Of United Stock Does Not Entitle The Trustee In Bankruptcy To A Reduction In The Judgment To $180,856.

Since intervenor-appellant's opening brief has reiterated some of the same arguments made in appellant DePinto's opening brief in DePinto v. Provident Security Life Insurance Company, 9 Cir., 1963, 323 F.2d 826, Docket No. 18245, appellee refers the court to pages 43 through 62 of appellee's brief in No. 18245.

Additionally it is submitted that the doctrine of restitution

is neither applicable here nor should be applied if applicable.

Restitution does not apply because the surrender of the 38,798 shares of United stock by American did not restore United's $314,794.19 or its equivalent. The United-Provident merger agreement stated, in paragraph 3, that Provident had, at the date of the agreement, issued 104,000 shares of its capital stock for $2.00 a share of which $ .30 a share was allocated to expenses and compensation and $1.70 being the proceeds to Provident. Thus, the Provident stock had a fair market value of no more than $2.00 per share although it was actually only worth $1.70 since that was all that found its way to Provident. Assuming the best from appellants' point of view, the Provident stock had a fair market value of $2.00 a share. Therefore, the total value of all of the United stock on the date of the merger is easily determined because the merger agreement provides in paragraph 6 thereof that each holder of 30 shares of United would receive 1 share of Provident stock and in paragraph 5 thereof that the total outstanding common stock of United was 100,000 shares. Consequently, the maximum number of shares of Provident stock to which the shareholders of United were entitled was 3,333 (100,000 of United divided by 30 equals 3,333). Since the 3,333 shares of Provident stock could not be worth more than the $2.00 per share, this means that the total received by the United shareholders could not exceed $6,666. Consequently, since 38.9 per cent of the United stock was cancelled, it follows that the maximum

value which could be attributed to the cancellation of the 38,798 shares of United stock is 38.8 % of $6,666 or about $2,593.07.

It is this $2,593.07 which appellants ask the court to deem to be restitution for the $314,794.19 lost by United on October 18, 1957. Further, they ask that it be so deemed although it did not restore the status quo and occurred in 1959 after the company had been bankrupted by the negligence and breach of fiduciary duty of the directors including DePinto. The person who takes two tickets to the last game of the World Series along with the rightful owner's new Ford does not restore the status quo if he returns the tickets a week after the game is played along with a damaged Ford. Restitution is not a doctrine which permits such a result to be invoked in defense of a claim against the person taking property. The argument appellants make here was made in the district court, and the Motion to Strike Defenses set forth the above figures.

Nor should the doctrine be applied as a matter of equity because he who seeks the aid of equity is required to do so with clean hands. Here the person for whom the trustee in bankruptcy speaks, appellant DePinto, has written a letter to the district judge, participated with Provident in the filing of a complaint in Provident's name although the complaint was prepared by DePinto and exculpated him from liability, signed and filed an affidavit of bias and prejudice

against the district judge five years after the latter was assigned to the case and which affidavit was based solely on rulings in the case, lied at the last trial below on a significant aspect of the claims against him (R.T. 499, 504, 505), admitted under oath that he had opened bank accounts in the names of others to avoid writs of attachment at a time subsequent to the entry of judgment here, and asked this court for an injunction in Docket No. 20308 here, a related case, to prevent execution of the judgment herein while at the same time he had an injunction in his pocket which had been obtained without notice from a Referee in Bankruptcy.

The contention of the trustee in bankruptcy that the judgment be reduced because less than 100,000 shares of United stock remains outstanding due to the said cancellation assumes that the suit here is a class action on behalf of only the remaining shareholders of United and that only they have an interest in the judgment entered. While it is true that such judgment may ultimately be for their benefit, it is not true that they only have an interest therein. There are two pending lawsuits in the U.S. District Court for the District of Arizona in which claims are being made against United and Provident by former policyholders of United, and in which Provident has denied it assumed liability of the type asserted therein. Walker v. Provident Security Life Insurance Company, Civil No. 4069, and Mauser v. Provident Security Life Insurance Company, Civil No. 4070. These

claims total $119,099.37, and they cannot be satisfied, if sustained, from Provident Security Life Insurance Company even if Provident's disavowal of assumption thereof is rejected. Further, the terms of the merger agreement between United and Provident permit the latter to deduct from the judgment here any proper charges against said recovery. Thus, it is clear that two California citizens, former policyholders of United, also have an interest in the judgment rendered below in Provident's favor.

The argument is also unsound because the district court has not rendered a decision in the pending suit to declare the United-Provident merger null and void, and there is pending therein a motion to amend the complaint by setting forth a cause of action based on violations of the Securities and Exchange Acts as well as regulations of the Securites and Exchange Commission. The parties are also attempting to negotiate a disposition of the case which may set aside the merger. In any event the corporate demise of United is still an open question in other litigation even though for purposes of ruling on jurisdictional questions here its merger with Provident must be accepted as the court ruled. Should United's continued existence be determined later, the reduction of a judgment in its and its successor's favor on the assumption that it no longer exists or will benefit from the full judgment here would damage its property rights severely.

Next, assuming that only the 57,452 shares of United have a

property right in the judgment herein, would it be, as the trustee in bankruptcy contends, "grossly inequitable and unjust" for such stockholders to recover 100% of the loss realized by United on October 18, 1957? First, they would not get the full $314,794.19 even if no policyholders' claims were allowed against it. Why? Because six years ago the district court awarded one-fourth of the judgment collected as legal and accounting fees, and it is reasonable to assume that, in view of the additional counsel required since then as well as the additional effort expended, the district court would not reduce the award. In addition there are litigation costs not recoverable from the judgment debtor under law, and such amounts, if allowed, would further reduce the recovery in a much smaller amount. Thus, it is not likely, in the best of circumstances, that such shareholders would realize more than $215,000 of the $314,794.19. This is about $35,000 more than the $180,856 which the trustee in bankruptcy says the judgment should be reduced to here. Would this $35,000 result in a payment which would be "grossly inequitable and unjust"? It hardly seems so in view of the fact that such shareholders also lost their equity in a going concern as a result of the negligence involved here.

Also, and viewing the question in the context of the bankruptcy proceedings, how realistic is it for the trustee in bankruptcy to claim that such stockholders would ever get such $35,000 more than the

$180,856? With total debts of $2,113,931.93 and total assets of $754,109.44 listed in the DePinto bankruptcy proceeding, it is more than likely that, if the judgment for $314,794.19 is affirmed here, the trustee in bankruptcy will then file a petition in the bankruptcy court seeking an order declaring the judicial lien obtained herein to be null and void. Should that succeed, the trustee in bankruptcy knows that the shareholders of United or any other claimants to the judgment herein would be fortunate if they recovered thirty to thirty-five cents on each dollar of the $314,794.19 judgment.

The trustee's reliance on the cases cited at pages 50 and 51 of his opening brief is misplaced. Each of those cases, with the exception of Stanton v. Schenck, (S.Ct. N.Y. 1931) 251 N.Y.S. 221, was responded to at pages 49 through 61 of appellee's brief here in No. 18245. Insofar as Stanton v. Schenck, supra, is concerned, the case does not aid appellants. It was a class action by shareholders for breach of fiduciary duty to all shareholders.

Appellants here are faced by the law of this case - that this is a stockholder's derivative action, and the recovery in such cases is, as is shown more fully at pages 43 through 61 of appellee's brief in No. 18245 here, in favor of the corporation. The first reversal was based on the absence of an indispensable party in a stockholder's derivative action, a ground raised by DePinto. He won. If he had lost, he could be heard to argue now this was a different action.

b.

The $100,000 Payment By The Duhame Estate, In Settlement Of $177,863.84 In Damage Claims For The Period Prior To October 18, 1957 When United Lost The $314,794.19 Which Is The Basis Of The Jury Verdict Against Appellant DePinto, Does Not Entitle The Trustee In Bankruptcy To A Credit Of $100,000 Against The $314,794.19.

Prior to the beginning of the trial below, the Duhame Estate, at a conference with appellee's attorneys and the district judge, sought to settle their liability herein for $100,000. At that conference, appellee's counsel advised the district judge that they refused to accept such a settlement unless it was in settlement of the $177,863.84 in claimed damages sustained by United during the period from June 30, 1956 through October 17, 1957, the period prior to the date when United lost the $314,794.19 in liquid assets. On Friday, June 11, 1965 the Duhame Estate formally announced its offer to the district court. (R.T. 147). Appellee's counsel immediately reiterated the said condition with the following statement:

> " If your Honor please, I think what Mr. Cavanaugh said should be supplemented by the fact that the acceptance of this offer by the plaintiffs is contingent upon an allocation of the funds in our opinion. It should be all to the first cause of

action. By that I mean the claim prior to October 17, 1957, certainly no less than $95,000.00 of it to be allocated to that, and whatever allocation is deemed by the Court to be appropriate not in an amount to exceed more than $5,000.00 to the other two claims, and we would petition and we would - we will present a formal petition to your Honor. But in order that the matter be disposed of now, we would petition that your Honor approve the settlement subject to the condition that I just stated, and with the direction that the payment be on account of that first claim and be allocated to that first claim, and if that condition is approved and such allocation is made by the Court, then we would recommend to the Court that the settlement be approved as fair and reasonable. I don't think it is any bonanza, but I think it on the minimum side, fair and reasonable, and in order to avoid further litigation with the Duhame defendants, we recommend that it be accepted and that the money be paid into court to be distributed pursuant to the court order.

" The Duhame defendants will also surrender their certificates of participation, which may or may not have any value, but if there is any value, that value should be assigned in precisely the same way as the settlement itself." (R.T. 148, 149).

Thereupon, appellant DePinto stated through counsel " that so far as the settlement is concerned, the other defendants have no control or really have no voice in whether a settlement is made or whether it isn't", and that " I am not questioning the right of the parties to make settlement." (R.T. 151). Following that statement, appellant DePinto argued that there " is no other claim that has been formally or otherwise legitimately made in this case" other than the $314,794.19 claim relating to the October 18, 1957 loss by United, and therefore no allocation could be made by the district court. (R.T. 152).

The district court ruled that the $314,794.19 claim of damages occuring on October 18, 1957 was not the only claim; that the claim for damages for the period prior to October 18, 1957 had been vigorously presented and pursued, referring to rulings with respect thereto insofar as the pretrial order was concerned; and that the settlement was approved with the $100,000 being allocated, as conditioned by plaintiff's acceptance, to the $177,863.84 damage claims for the period from June 30, 1956 through October 17, 1957. (R.T. 155, 156, 157). In so ruling the district judge also relieved the remaining defendants, including appellant DePinto, of any need to defend further against the $177,863.84 damage claims for the period prior to October 17, 1957 by striking such claims from the balance of the trial. (R.T. 158, 159). One of the reasons given for so ruling was

that appellant DePinto and the other defendants had previously contended they would be prejudiced by any reference at the trial to such earlier amounts of claimed damages, and that by so striking the claims upon settlement of the $100,000, the possibility of prejudice would be removed. (R.T. 158, 159).

In short, not only did the district court credit one joint tortfeasor (DePinto) with a payment made by another joint tortfeasor (Duhame Estate), but it credited appellant DePinto with the entire $177,863.84 by virtue of striking the claims from the balance of the trial after application of the $100,000 on the said $177,863.84 claims for the period prior to October 18, 1957. Thus, the cases cited by appellant DePinto at page 52 of his opening brief are not pertinent.

Nevertheless, DePinto argues that the only claim pending against Duhame at the time of the settlement was the $314,794.19 lost on October 18, 1957, and that therefore the $100,000 payment must be applied thereto so that he is entitled to a credit. This is incorrect on the merits, as will be shown, but before doing so the appellee challenges the standing of appellant DePinto to object to settlement made by Duhame of all of the claims made against it. That is, if the Duhame Estate, against whom appellee had made claims for the period prior to October 18, 1957 of $177,863.84, for October 18, 1957 of $314,794.19, and for the period subsequent to October 18,

1957 of $60,695.60, chose to settle all of those claims for $100,000, and the appellee accepted such offer only on the condition that all of the said sum be applied in payment of the $177,863.84 damage claims for the period prior to October 18, 1957, where does appellant DePinto obtain standing here to question, interpret, challenge, or modify such settlement? Had appellee filed action against the Duhame Estate for only the $177,863.84 claimed damages for the period prior to October 18, 1957 and a separate action against DePinto for the $314,794.19 lost on October 18, 1957, DePinto would have no right or claim to a credit on a $100,000 settlement therein. And where the Duhame Estate settled three classes of claims on the foregoing basis, what right would DePinto have here in this action to argue that in the Duhame action there was only one claim pending (the $314,794.19)? That issue has been foreclosed in the Duhame action, and DePinto cannot assert here, in a separate action, arguments which the Duhame Estate does not make, and which they chose not to make when it was decided to settle their liability. The settlement with the Duhame Estate was predicated on the recognition and validity of the pre-October 18, 1957 damage claims of $177,863.84, and DePinto is foreclosed from attacking that recognition in this action. As far as the record is concerned, the Duhame Estate did not state why they settled the claims against them. Can DePinto point to evidence that demonstrates that the Duhame Estate did not decide to settle for the $100,000 precisely

because they judged the pre-October 18, 1957 claims of $177,863.84 to be valid and dangerous? For all the record shows the Duhame Estate may have had a valid and sound defense to the October 18, 1957 claim of $314,794.19 claim but none as to the pre October 18, 1957 claims. Thus, assuming arguendo, and for the moment only, that appellant DePinto had an absolute defense to the pre-October 18, 1957 claims of $177,863.84, such as he is now making here, that does not entitle him to penetrate another action (the Duhame action), and extract a defense from that lawsuit to help his cause here. The critical fact is that the Duhame Estate and appellee were entitled to settle the various claims as they saw fit, and they are not obliged to settle on a basis which another defendant deems more favorable to him.

What DePinto is asking the court to do is overturn the basis upon which appellee settled his lawsuit against the Duhame Estate under circumstances in which the court cannot permit or order the Duhame Estate case to be tried in view of such a rejection of the Duhame Estate settlement. That is, appellee should be entitled to proceed with his lawsuit against the Duhame Estate if the terms of his settlement are overturned as they would be if the October 18, 1957 claim of $314,794.19 received a credit of the $100,000 instead of the pre-October 18, 1957 claims of $177,863.84. Appellee would prefer to proceed against the Duhame Estate for the total of the three claims or $553,353.63 if he is required to apply $100,000 against

the $314,794.19 lost on October 18, 1957. The reason appellee was willing to accept $100,000 in settlement of all of the claims against the Duhame Estate was because it resulted in a settlement which did not lose any of the $314,794.19 claim. Otherwise the appellee required a larger sum before settlement with the Duhame Estate was acceptable. Therefore, the terms of that settlement should not be disturbed, at DePinto's request, unless appellee also has the right to proceed with his claims against the Duhame Estate. Since the case involving the Duhame Estate is not before the court and appellant DePinto is without power to return matters to the status quo before the Duhame Estate settlement so that appellee could proceed against the Duhame Estate, his contention that he should get the benefits of an overturning of that settlement while appellee is still bound thereto is untenable.

Turning to the merits of appellant DePinto's contention that there was only one claim for $314,794.19 lost to United on October 18, 1957 in the action against the Duhame Estate, assuming that he has standing to so contend in view of the settlement, it is noted that there is no merit to the argument.

In the Amended Complaint filed by John S. Gorsuch on November 16, 1959, at paragraphs 87, 88 and 89 of Count VI, claims were made against Elmer W. Duhame and appellant DePinto for breach of fiduciary duty and responsibilities to United resulting in

damages occurring on October 18, 1957 of $308,000, and prior to October 18, 1957 of $45,514.51 and $109,723.82. (T.R. 18). The $45,514.51 related to disbursements made to Kelly and the $109,723.82 concerned disbursements to United Finance. (T.R. 18). Later in the pretrial order of March 9, 1959, the plaintiff's contentions stated that appellant DePinto and Elmer W. Duhame breached their fiduciary duty to United in that they failed to exercise that diligent care and skill which ordinarily prudent men would exercise under similar circumstances in like position by permitting the transfer of $314,794.19 of United's assets to American, by permitting through malfeasance the taking from United of $46,839.51 and the transfer of $86,000 to United Finance. (O.T. 245, 246). The $46,839.51 related to amounts disbursed to Kelly. (O.T. 243, 244, 246).

After trial during which the evidence heard concerned all of the above claims, the district court entered judgment only for the $314,794.19 lost on October 18, 1957. (O.T. 354). This judgment was however reversed and remanded by this court to permit intervention. Niesz v. Gorsuch, 9 Cir., 1961, 295 F.2d 909. A second judgment, also for just the $314,794.19, was reversed after Albert J. Doig had intervened as a plaintiff. (T.R. 26). This court held that having intervened as plaintiff in a class action brought by Gorsuch, and having introduced no new cause of action

therein, the filing of the Gorsuch complaint inures to Doig's benefit. Therefore, it is incorrect for appellant DePinto to state that under this court's decision in Niesz v. Gorsuch, supra, the Gorsuch complaint must be treated as non-existent. It follows that the existence of the additional claims in the Gorsuch amended complaint, giving notice to the Duhame Estate, cannot be avoided by such an argument. The same answer applies to appellants' contention that the statute of limitations ran on such claims. This court has already rejected that argument here in DePinto v. Provident Security Life Insurance Company, 9 Cir., 1963, 323 F.2d 826.

Following the second reversal here, a second pretrial order of 102 pages was prepared. (T.R. 91-194). Therein claims were made against the Duhame Estate for damages to United in the sum of $177,863.84 for the period between June 30, 1965, for $314,794.19 on October 18, 1957, and $60,695.60 for the period between October 19, 1957 and June of 1959. (T.R. 151, 159, 160). It was set forth therein, as it had been in the March 9, 1960 pretrial order, that Elmer W. Duhame had breached his fiduciary duty to United with respect to unwarranted payments of salary, travel allowances, travel expenses, legal fees, personal expenses of Kelly and his family, expenses of United Finance Corporation, advances and unauthorized loans, payments of excessive salaries, and actuarial fees. (T.R. 151, O.T. 227-234, 246).

In short, the Duhame Estate had notice of the pre-October 18, 1957 claims of $177,863.84 on November 16, 1959, again in detail in the first pretrial order of March 9, 1960, again in the fall of 1964 when the district court notified all counsel that the entire case was open both as to claims and theories, again prior to May 17, 1965 when the pretrial order was being prepared and submitted in draft form to all counsel, and again in the pretrial order of 1965. (T.R. 77, 85). It is therefore untenable for appellants to argue that there was only one claim against the Duhame Estate, and that in the amount of $314,794.19. It follows there is no merit to the contention that the $100,000 settlement with the Duhame Estate must be credited to the $314,794.19 claim made against the Duhame Estate rather than the pre October 18, 1957 claims against the Duhame Estate in the sum of $177,863.84. Appellee settled those claims with the Duhame Estate only on the reservation or condition that the sum be applied to and settle the pre-October 18, 1957 claims of $177,863.84. Appellant DePinto was thus relieved from having to defend against such claims and any potential liability therefor. He is not entitled to invade that settlement in another lawsuit, and in effect argue in a separate action that the $100,000 was not paid in settlement of such claims against the Duhame Estate.

c.

Interest Was Properly Allowed From October 18, 1957, The Date United's Loss Occurred.

The appellant DePinto and appellee, in the pretrial order entered June 10, 1965, and in the statements to the district court, stipulated and agreed that the issue of from what date interest would run was an issue to be decided by the district judge. (T.R. 168). Since the instant action is a stockholders' derivative action, an equitable action unknown to the common law and an invention of equity, it follows that the parties agreed the issue could be determined by an equity court. Therefore, because the rule in equity is that interest on an unliquidated claim is in the trial court's discretion,[8] the burden was on appellant DePinto and the intervenor trustee in bankruptcy to show by clear proof that the trial court abused its discretion.[9] This the appellants have not attempted to do, and not having made such a contention supported by argument in the opening brief, they have abandoned the point. Peck v. Shell Oil Co., 9 Cir., 1944, 142 F.2d 141, 143; Stetson v. United States, 9 Cir., 1946, 155 F.2d 359, 361. In this case,

8. Niesz v. Gorsuch, 9 Cir., 1961, 295 F.2d 909.
9. Miller v. Robertson, 266 U.S. 243, 258 (1924); Speed v. Transamerica Corp., 3 Cir., 1956, 235 F.2d 369, 374; Goldberg v. Paramount Pictures, 2 Cir., 1936, 85 F.2d 42, 45; Chrisholm v. House, 10 Cir., 1950, 183 F.2d 698, 709; Dorsett v. Shore, 4 Cir., 1957, 254 F.2d 373; United Light & Power Co. v. Grand Rapids Trust Co., 6 Cir., 1947, 85 F.2d 331, 338.

by the filing of this brief, appellee's opportunity to answer is closed, and such a contention by the trustee in bankruptcy and appellant De Pinto during oral argument will not afford appellee the fair notice and reasonable amount of time necessary to prepare a reply.

The second reason why interest was properly allowed from October 18, 1957 is that the modern law holds that interest is allowable on unliquidated damages from the date the damages were sustained in order to fully and fairly compensate the injured party. 36 ALR 2d 337 et seq. Here the damages occurred on a date nearly nine years ago, and the element of time is an important consideration. The United stockholders or United will not be fully compensated unless they receive the value of the property and the income therefrom since that date. If the rule were otherwise, it pays appellant DePinto to litigate indefinitely even if he knew to a certainty that he was liable. The reason is that he or the trustee in bankruptcy have already been able to earn 54% of the $314,794.19, and in eight more years would begin to make a profit from the negligence of appellant DePinto. Thus, an application of the doctrine of unjust enrichment requires the allowance of the interest from October 18, 1957.[10]

Next, the law of Arizona,[11] contrary to the contentions of the trustee in bankruptcy, allows interest from the date of the loss in

10. Recent Developments, Prejudgment Interest As Damages, 15 Stanford L. Rev. 10 for discussion of the allowance of prejudgment interest on the theory of unjust enrichment in negligence cases.

11. Absent an Arizona decision in point, Concordia Ins. Co. v. School Dist., 1931, 282 U.S. 545, holds the court has discretion to include

a stockholder's derivative action on a corporate claim for unliquidated damages resulting from loss of its property. Zeckendorf v. Steinfeld, 15 Ariz. 334, 138 P. 1044. This case has not been overruled, as will be shown, and cannot be distinquished, as the opening brief attempts, on the theory that it only involved money and therefore the damages were liquidated. It is the only Arizona case in point, and it allows interest on a corporate claim for unliquidated damages resulting from loss of its property.

In Zeckendorf, supra, the one claim which was sustained by the Supreme Court of the United States, Zeckendorf v. Steinfeld, 225 U.S. 445 (1912), was that arising out of a sale of its mining properties for $515,000, payable $115,000 in cash and the balance in four promissory notes of the purchasers, the Imperial Copper Company, payable in four equal quarterly installments. Zeckendorf charged on behalf of the corporation that Steinfeld unlawfully obtained part of the proceeds of the said sale, and proved that Steinfeld received the sum of $145,743.75 and one of the said promissory notes for $100,000 given by the Imperial Copper Company.[12] The final judgment was inspected by the Arizona Supreme Court which found that such judgment "is in accordance with the opinion and judgment of the Supreme Court, in that it is against Steinfeld and in favor of the Silver Bell Company

12. See Zeckendorf v. Steinfeld, 12 Ariz. 245, 260, 100 P. 784, 789, and Zeckendorf v. Steinfeld, 225 U.S. 446, 458, for a statement of the above facts.

for the amount of money and the property appropriated by Steinfeld to his own use." Zeckendorf v. Steinfeld, 15 Ariz. 334, 339, 138 P. 1044, 1046. The judgment also allowed the corporation "interest at 6 per cent per annum on the amounts recovered, from the date of the wrongful conversion."

The Arizona court then affirmed such allowance of interest "for the amount of money and the property appropriated" from the date of loss stating:

> " In United States v. North Carolina, 136 U.S. 211, 222, 34 L.Ed 336, 341, 10 Sup. Ct. Rep. 920, 922, the court said: ' Interest, when not stipulated for by contract, or authorized by statute, is allowed by the courts as damages for the for the detention of money or property, ... ' * * *
>
> " ...It cannot be said that the lawful owner of property is fairly or reasonably compensated by an award of the return to him of his property or its value. As we understand it, the general rule, both at law and in equity, is that the owner is entitled to the return of his property or its value at the time of its wrongful conversion, together with damages which are usually estimated at the legal rate in the absence of a statutory rule." (Underscoring supplied)

Here the property lost was cash, promissory notes, bonds, mortgages, and accrued interest. Therefore, under Zeckendorf, supra, the

law of Arizona requires the allowance of interest here from October 18, 1957 as the district court ruled.

More importantly the Arizona Supreme Court in a 1962 case allowed interest on unliquidated damages resulting from negligence, and allowed the interest from the date the damages occurred. Desert Waters, Inc. v. Superior Court, 91 Ariz. 163, 370 P. 2d 652. There the court held that if a condemnor who, after being granted possession prior to the date as of which the compensation is fixed, negligently diminishes the value of the property, compensation and damages therefor must be included in the award to the condemnee, and because the condemnee is deprived of the use of his property between the date of such entry and the date when compensation is paid to him, he is "entitled to interest on the amount of the award from the date of entry by the condemnor."

The 1962 decision in the Desert Waters, Inc. case, supra, not only reaffirms the doctrine of Zeckendorf, supra, allowing interest from the date of loss of property, but shows that the Arizona Supreme Court approves the modern view allowing interest on unliquidated negligence claims.[13] It also makes it plain that appellants' citation of the earlier cases of Schwartz v. Schwerin, 85 Ariz. 242,

13. "In actions for tortious injuries, damages usually now include interest, and are set by the jury when no ascertainable standards or measures are available." Oleck, Damages To Persons And Property § 300 at 641, 651 (1955 ed).

336 P.2d 144, and Arizona Eastern R. Co. v. Head, 26 Ariz. 259, 224 P. 1057, does not sustain their view.

In Schwartz v. Schwerin, supra, the claim was for attorney's fees on a quantum meruit basis. The court denied interest from the date of demand holding that the general rule denies interest on unliquidated demands for services until rendition of judgment. In order to reach that result it first had to expressly overrule three earlier cases involving claims for street repair work, road work, and ground leveling work respectively. The fact that the court's holding is limited to interest on unliquidated demands for services rendered, and its opinion did not overrule the Zeckendorf case, supra, while expressly overruling three other cases, demonstrates that Schwartz v. Schwerin, supra, does not support the principle that interest is not allowed from the date of loss of property by a corporation.

The same is true of the Arizona Eastern R. Co. case, supra. There two members of the Arizona Supreme Court refused to allow 12 per cent interest on the judgment from the date of filing suit because the interest claim was based on a section of the Workmen's Compensation Act which it held unconstitutional. The case is not at all concerned with the issue raised by appellants.

The foregoing shows that the interest is allowable even if the claim was unliquidated. An additional reason why interest is allowable is that appellant DePinto conceded the claim was liquidated in the pretrial order filed March 9, 1960. There, after agreeing that

$314,794.19 of specific assets were taken from United on October 18, 1957, he stated that "there are no material issues of any material fact as to him." (O.T. 237, 239, 261). Also, it is apparent that the $314,794.19 is readily calculable from the $166,498.66 in cash, $87,626.88 in promissory notes and accrued interest, and $60,668.65 in mortgages, bonds and accrued interest. According to appellants' theories, there is no argument that the $166,498.66 in cash is a liquidated claim. And under Zeckendorf, supra, the notes of $86,000 plus accrued interest draw interest from the date of loss; so, too. should the $60,668.65 of mortgages, bonds, and accrued interest which constitute property similar to that in Zeckendorf, supra.

Appellants' position in effect is that if one takes $314,794.19 from a corporation, leaving in exchange therefor a worthless tea kettle which the taker claims has great antique value, there can be no interest awarded on such damage because the value of the tea kettle must be determined to ascertain damages. So they argue here when they say that, since it was necessary to determine that the American stock was worthless, the damages are unliquidated and interest from the date of loss cannot be awarded. Such arguments prove the wisdom of the modern rule which permits interest on unliquidated claims as part of damages to allow full and fair compensation.

For the above reasons, and those contained at pages 63 through 71 of appellee's brief in No. 18245, the district judge should not be reversed for his order allowing interest from October 18, 1957

d.

Appellants Are Not Entitled To A Reduction Of The Judgment From $314,794.19 To $308,000 Because Of Judgments Entered Against Other Joint Tort Feasors For $308,000.

On the eve of the first trial in March, 1960, defendants James E. Kelly, L. N. Kelly, Nina Dunn and J. L. Jenkins stipulated to the entry of consent judgments against each of them in the amount of $308,000 (T.R. 24) which were entered after a trial had been had with respect to the liability of DePinto and others who had not confessed judgment. The trial court also entered judgment against DePinto and others in the amount of $314,794.19. Although DePinto appealed from that judgment (Cause No. 17114) he did not assign as error the entry of judgment against him therein in an amount in excess of that which was entered against James E. Kelly, L. N. Kelly, Nina Dunn and J.L. Jenkins. Having failed to do so then, he cannot be heard to complain now. That issue, if it ever was an issue, was abandoned by DePinto on the first appeal and he is precluded from raising it at this late date.

However, even if DePinto had not previously waived the contention of error he is now attempting to assert, it is, nonetheless, without merit for it is hornbook law that a judgment is not a release. A judgment entered by stipulation, that is, a so-called "consent judgment" is just like any other judgment. Cochise Hotels v. Douglas Hotel Operating Co.,

83 Ariz. 40, 47, 316 P. 2d 290; Wall v. Superior Court, 53 Ariz. 344, 89 P. 2d 624. Since the consent judgments entered against James E. Kelly, L. N. Kelly, Nina Dunn and J. L. Jenkins were not releases, the "rules applicable to a release" relied upon by DePinto at page 56 of his brief are not relevant.

Furthermore, since the judgment from which the present appeal is being taken is one which was entered against DePinto alone after a trial against him alone, the rule that the jury may not apportion damages amongst joint tortfeasors is also irrelevant. For that reason the section of 49 CJS, Judgments which DePinto has cited at page 56 of his brief together with cases taken from the footnotes to the said section of CJS is not in point.

It remains to be noted that it is also hornbook law that a judgment entered against a joint tortfeasor constitutes a discharge of other joint tortfeasors only when and to the extent that the said judgment is followed by actual satisfaction thereof. Thus, DePinto's liability can be discharged only to the extent that judgments entered against any of the other joint tortfeasors have been satisfied. That, it is submitted, is a matter which can be raised by DePinto in the district court at such time as satisfaction is sought from him.

The District Judge Did Not Abuse His Discretion In Granting A Motion To Consolidate The Suits Involving Sabo, Landoe And Pegram, Being Civil No. 2974 And Civil No. 3062, And Ordering A Separate Trial For DePinto.

During the earlier appeals here, appellant DePinto, speaking through his present counsel, complained in his briefs that "DePinto got lost in the shuffle," and that when "the lower court machine-gunned the cast of characters," the "widespread fusillade caught DePinto." He then pleaded that the court should "focus its judicial microscope" on the parts of the record related to him. In short, DePinto was contending that he had been prejudiced or harmed by having had to try his case along with several others whose conduct had been very bad. However, when the district court eliminated any such danger for the third hearing by ordering a separate trial, DePinto reversed his field and claimed that it was error and prejudicial that a trial be had as to his liability and his alone.

The most surprising aspect of the present position and claim of error is that had the district court ordered DePinto to proceed to trial with Sabo, Landoe and Pegram, the appellee would have been entitled to have a hearing on his Securities and Exchange Acts cause of action against Sabo and Landoe which Landoe wanted consolidated

with Civil No. 2974, and in the Securities and Exchange Act case the jury would have heard testimony and examined exhibits offered to show violations of such acts.

Perhaps it would be helpful to the court to have before it some of the relevant facts relating to appellants' latest contention that DePinto was entitled to a trial with others and was prejudiced by a separate trial as to his liability.

The complaint in Civil No. 2974 was filed on November 4, 1958. (O.T. 3, 22). That complaint did not name Francis I.Sabo and Hjalmer B. Landoe of Bozeman, Montana as defendants. Rather, on May 25, 1959 a complaint was filed by John S. Gorsuch asserting a civil cause of action for damages on behalf of United and against Sabo and Landoe based on violations of the Securities and Exchange Act and regulations of the Securities and Exchange Commission. Gorsuch v. Francis I. Sabo and Hjalmer B. Landoe, Civil No. 3062, Phoenix. Included in the claims therein was the loss of $314, 794. 19 to United on October 18, 1957. Answers were filed by Sabo and Landoe on July 10, 1959.

However, on August 25, 1959 Sabo and Landoe filed a motion to intervene in this action, and leave was granted on September 14, 1959. (O.T. 1346, 1347). On June 1, 1965 appellee moved to consolidate for purposes of trial the hearing in Civil No. 2974 and that in Civil No. 3062. (T.R. 290). Later, on June 3, 1965 the Duhame Estate filed a motion for a separate trial pursuant to the

provisions of Rule 42 (b), Federal Rules of Civil Procedure. (T.R. 290). The Duhame motion for separate trial stated that such defendant would be prejudiced and that confusion would result. (R. T. 11, 12). Thereafter, on June 10, 1965 appellee agreed that the Duhame Estate's motion for separate trial should be granted, asked that trial proceed against the Duhame Estate, offered to proceed with the trial against DePinto immediately thereafter, and suggested that some time elapse before a hearing on the cases involving Sabo, Landoe and Pegram. (R.T. 7, 11). One of the reasons given by appellee for agreeing with the Duhame Estate's motion for a separate trial was the following:

> " What I am concerned about is that regardless of the results of the consolidated trial these people will go up to the Court of Appeals and will be threshing around for the next two or three years because they claim they have been prejudiced by something that some other defendant did, or by evidence that was introduced against some other defendant.
>
> " I think that this would wipe out that aspect of the case completely out of the courtroom, and the only problem would be whether there was a fair trial against Duhame, and Duhame alone." (R.T. 12).

Thereupon, the district court asked DePinto to state his position. DePinto stated that if the case was to start against DePinto alone, he "would object very strenously to going it alone", but that "if the

case were to be deferred as to the defendant DePinto so that we might not have to face it at all, then I would have to say that I couldn't quarrel with it." (R.T. 16, 17). Sabo, Landoe and Pegram adopted the same view as DePinto. (R.T. 18).

At 9:30 A.M. on Friday, June 11, 1965, the date set for trial, the Duhame Estate offered to settle its liability for $100,000 by making a formal offer in court, and appellee accepted upon certain conditions. (R.T. 147, 148, 149). Thereupon, appellee renewed his motion to consolidate Civil No. 2974 and Civil No. 3062, the latter being the Securities and Exchange Act case against Sabo and Landoe. (R.T. 164, 165). Appellee also moved to proceed as to the trial of DePinto's liability in a separate trial. (R.T. 165). Landoe and Pegram objected to two trials in Civil No. 2974 and Civil No. 3062, agreed to the appellee's motion to consolidate, and moved for a continuance. (R.T. 167). Sabo agreed to the separate trial with respect to DePinto. (R.T. 168). DePinto objected to a separate trial as to him on the twin grounds that it was his "assumption" that appellee was going to call Sabo, Pegram and Landoe as witnesses which would mean, if a separate trial was held as to DePinto, that he could not examine these persons, and that DePinto had cross-claims against Sabo, Pegram and Landoe that he would be prevented from trying. (R.T. 166, 169).

In view of DePinto's first objection that he would be unable to examine Sabo, Landoe and Pegram, none of whom had been served

with subpoenas due to their residence outside of Arizona, the district judge directed counsel for Sabo, Landoe and Pegram to make those persons available as witnesses. (R.T. 171, 172) At that point DePinto's counsel was asked which witnesses he wished to appear, and he answered:

> " If your Honor please, I think the only person that we would want to call would be Mr. Landoe." (R.T. 173).

The witness Landoe was never called by DePinto at the subsequent trial nor was any report made to the district judge that Landoe had not been made available.

With respect to the other objection to the separate trial for DePinto - that he had cross-claims against Sabo, Landoe and Pegram - the district judge ruled that they were contingent cross-claims depending on DePinto's liability, and that they could be tried, if necessary, in the consolidated actions against Sabo, Landoe and Pegram in Civil No. 2974 and Civil No. 3062. (R.T. 170). It was also pointed out that it had been held in this action in March of 1930 that under Arizona law contribution between joint tort feasors was not permitted, and the cross-claims were dismissed. (O.T. 318, 319; R.T. 169, 170).

The district court then granted the motion to consolidate Civil No. 2974 and Civil No. 3062 with respect to Sabo, Landoe and Pegram which had previously been agreed to by Landoe and

Pegram, and granted a separate trial as to DePinto after granting the motion for continuance of Landoe and Pegram with respect to the consolidated cases in Civil No. 2974 and Civil No. 3062. (R.T. 170, 171). It also continued the beginning of the trial of the DePinto case until the following Monday, June 14, 1965 and directed that the jury be empanelled during the afternoon of June 11, 1965. (R.T. 173).

In view of the foregoing, DePinto's two objections made to the district court with respect to a separate trial as to him are without merit. The district court went to great lengths to see that he had an opportunity to examine Sabo, Landoe and Pegram who were made available to him. He chose not to call such witnesses, and told the trial court so. How can he possibly, in the face of that record, tell this court that he was deprived of an opportunity to examine those witnesses? And as was shown the right to try his cross-claims has not been denied him should his liability be affirmed here. If in the face of the Arizona law denying the right of contribution to joint tort feasors, the trustee in bankruptcy should wish to press an action against Sabo, Pegram and Landoe at the hearing on Civil No. 2974 and Civil No. 3062, the district court has already ordered that he has that right.

It is also incorrect for the trustee in bankruptcy to conclude that "as a result of the trial Court's action, the attorneys for plaintiff

presented evidence to the jury only in the form of documents, 'admitted facts' and testimony adduced at the initial trial." That judgment was made prior to the decision of the district court since there was no way for appellee to compel the attendance of the Montana defendants. Thus, the appellant DePinto was given a right which appellee did not have. The statement also leaves the impression such evidence was the only evidence offered at the trial whereas DePinto testified. In any event if the evidence produced was not sufficiently persuasive, that would be to DePinto's benefit since it was the appellee who was required to carry his case by a preponderance of the evidence.

The district court specifically referred to its power to order a separate trial under Rule 42 (b) when considering the Duhame Estate's motion for a separate trial, and Rule 42 (a) provides for consolidation. Thus, the contention of the trustee that Rule 21 authorizes a severance only where there has been a misjoinder of parties is neither applicable nor correct. After referring to the last sentence of Rule 21 that: "Any claim against a party may be severed and proceeded with separately", 3 Moore, Federal Practice § 21.05 at 2910 states:

> "Does the quoted sentence also authorize the court to sever and proceed separately with a claim that was properly joined? In many, perhaps most cases, the question need not

be answered for severance is unnecessary, since Rule 42 (b) gives the court a broad power in furtherance of convenience or to avoid prejudice to order a separate trial of any claim, or of any number of claims or issues. ... there are, however, occasions when the last sentence of Rule 21 may properly be used to sever a claim that has been properly joined."

Therefore, since the district court has the discretion under Rule 42 (b) to order a separate trial,[14] Rule 21 does not prohibit it from doing so and there are even instances where Rule 21 itself allows a separate trial. The trustee in bankruptcy was required to show that the district court abused its discretion under Rule 42 (b), and he has not attempted to do so.

The trustee's statement that "it is obvious that the action of the trial court was highly prejudicial to DePinto" is a statement of conclusion or preference. Why was he prejudiced by a separate trial as to his liability alone? Was it prejudice when the district court protected him from being "lost in the shuffle" or "machine - gunned" down while among a "cast of characters"? The appellee had the right initially to name him as the only defendant against whom the action was brought. If he is prejudiced by a separate trial now, then naming him alone would constitute the same prejudice.

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14. Bedser v. Horton Motor Lines, Inc., 4 Cir., 1941, 122 F.2d 406.

In like fashion his contention that he was placed in the position of "a 'target' defendant for the jury to shoot at" is not, even if it were correct, sufficient as error. Every joint tort feasor who remains to the end of litigation is a 'target' defendant in that sense. Should appellee settle and enter covenants with Sabo, Pegram and Landoe, DePinto would not even be able to argue this point because he concedes he has no right to prevent settlement with other parties. All the trustee is arguing is that DePinto was prejudiced because the jury and the district court were able to focus their respective "judicial microscopes" on his liability, and because he was not "lost in the shuffle." The burden of his contention is that he has a right to confuse a jury and play upon its emotions so that it is more likely to pass the entire burden on to the defendants from Montana.

Lastly the trustee's statement that the "conclusive evidence of the prejudice to DePinto is found in the verdict rendered in his favor at the initial trial" is invalid. If the verdict in a party's favor at an earlier trial constituted conclusive evidence of prejudice when a later jury reached a different result, there would be no point in this court ever remanding a case for a new trial after a jury verdict.

Since appellee instituted his Securities and Exchange Act case against Sabo and Landoe prior to the time when each intervened in the instant action, it ought to follow that he is entitled to a hearing

therein prior to or at least at the same time with the instant action in which they intervened and that Sabo and Landoe are not required to defend two trials instead of one. All the trustee is going to require, in order that he can have a trial with Sabo, Landoe and Pegram, is that appellee must be deprived of a hearing in Civil No. 3062 until after DePinto has had a joint trial with Sabo, Landoe and Pegram, that appellee not settle the instant action with Sabo, Landoe and Pegram, that Sabo and Landoe defend two lawsuits at two separate times, and that the district court must accomodate its trial calendar to these needs. The only other solution would be if DePinto had defended his case in the same consolidated hearing with Civil No. 3062 in which case he would no doubt assign as error the prejudice which occurred when the jury heard testimony and looked at documents proving that other defendants had violated the Securities and Exchange Act and the regulations of the Securities and Exchange Commission.

The district court should not be reversed for giving the appellant DePinto the very kind of trial which eliminated any chance that he would be "lost in the shuffle" and thereby prejudiced. It resolved the matter in the best interests of all of the defendants. No joint tort feasor is prejudiced by a separate trial as to his liability alone. What better way is there, if a plaintiff is ready to take the additional burden, of insuring that a defendant is not prejudiced by the presence of other defendants?

The District Judge Did Not Err In Proceeding After Appellant DePinto Filed An Affidavit Of Bias And Prejudice, And Appellant DePinto Was Not Deprived Of A Fair Trial.

The affidavit of bias filed by appellant DePinto was filed after this court had rejected, in 1964, his motion to have the case assigned to another judge and after appellee had filed a motion for partial summary judgment as to liability only.

Appellants contend that the mere act of filing the affidavit of bias and prejudice under 28 U.S.C.A. § 144 deprived the district judge of any power to proceed. They cite as authority therefor Berger v. United States, 255 U.S. 22 (1922). The case does not so hold. It ruled that though the challenged judge may not pass on the truth of the alleged facts, he may decide whether the affidavit meets the procedural requirements laid down in the statute and whether the facts give fair support to the charge of bias and prejudice. (Berger v. United States, supra, p. 33-34).

The statute itself provides that whenever a party in a district court proceeding files a "timely and sufficient affidavit that the judge before whom the matter is pending has a personal bias or prejudice either against him or in favor of any adverse party, such judge shall proceed no further therein, but another judge shall be assigned to

hear such proceedings." It further requires that the affidavit "shall state the facts and the reasons for the belief that bias or prejudice exists." When such an affidavit is filed, the only question is whether, assuming the correctness of the facts alleged, they are legally sufficient to show "personal bias or prejudice." Berger v. United States, supra.

A judge is not personally biased and prejudiced within the meaning of this provision because of opinions or judgments that he has formed on the basis of the proceedings or evidence in the case before him. "The bias or prejudice which can be urged against a judge must be based on something other than rulings in the case" (Berger v. United States, supra, p. 31). To be disqualifying, the alleged bias and prejudice must be against the defendant personally, i.e., it must stem from some extra-judicial source and must lead the judge to form an opinion as to the merits of a particular legal controversy on some basis other than what he has learned through his participation in the case. Berger v. United States, supra; Ex parte American Steel Barrel Co., 230 U.S. 35; Lyons v. United States, 325 F.2d 370 (C.A. 9); Gallarelli v. United States, 260 F.2d 259 (C.A. 1); Craven v. United States, 22 F.2d 605 (C.A. 1), certiorari denied, 276 U.S. 627; United States v. Garden Homes, 113 F. Supp. 415 (D. N.H.), affirmed per curiam, 210 F.2d 281 (C.A. 1); United States v. 16,000 Acres of Land, 40 F. Supp. 645

(D. Kan.). "Impersonal prejudice resulting from a judge's background or experience",[15] his "comments and criticisms",[16] "indiscreet expressions",[17] irritation at a party's dilatory tactics[18], or hostility toward counsel[19], do not establish the personal bias and prejudice which the statute requires for disqualification. A fortiori, an opinion formed from the evidence in the case cannot ground a charge of personal bias and prejudice. Ryan v. United States, 99 F. 2d 864 (C.A. 8), certiorari denied, 306 U.S. 635; United States v. 16,000 Acres, supra.

The affidavit of bias and prejudice filed by appellant DePinto contains no allegations whatever asserting personal bias and prejudice, Instead it is a recitation of the rulings and actions in this cause with which appellant DePinto disagrees. Therefore, U. S. District Judge Carl A. Muecke, to whom the matter was assigned after Judge Boldt referred it to Senior U. S. District Judge James Walsh, was correct in ruling that the affidavit failed to show facts or reasons to indicate personal bias or prejudice on the part of Judge Boldt. (T.R. 287). To the extent it was necessary Judge Boldt affirmed or concurred in Judge Muecke's ruling. (T.R. 287).

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15. Eisler v. United States, 170 F. 2d 273 (C.A.D.C.), certiorari dismissed, 338 U.S. 883; Price v. Johnston, 125 F. 2d 806 (C.A.9).
16. Scott v. Beams, 122 F. 2d 777 (C.A.10), certiorari denied, 315 U.S. 809.
17. In re Lisman, 89 F. 2d 898 (C.A.2).
18. Refior v. Lansing Drop Forge Co., 124 F. 2d 440 (C.A.6), certiorari denied, 316 U.S. 671.
19. Sanders v. Allen, 58 F. Supp. 417 (S.D.Calif.)

The affidavit of bias and prejudice was also untimely as Judge Muecke ruled. It was filed nearly five years after Judge Boldt was assigned to the case, and after appellee had filed a motion for partial summary judgment as to liability only. (T.R. 287).

Also, the affidavit of bias and prejudice was, as Judge Muecke also ruled, not appropriate in view of the earlier decision of this court rejecting the motion of DePinto that the case be assigned to another judge.[20]

There is a further reason, not mentioned by Judge Muecke, why the affidavit is defective. The certificate of counsel is not sufficient in that it merely certifies that the client was in good faith in making the affidavit. United States v. Flegenheimer, 14 F. Supp. 584 (N.J., 1935). Section 144 requires that the affidavit "shall be accompanied by a certificate of counsel of record stating that it is made in good faith." This provision has been construed to mean that the good faith of counsel of record as well as the good faith of the client must be certified. United States v. Gilboy, 162 F. Supp. 384, 392; United States v. Flegenheimer, supra.

Throughout the argument in appellants' opening brief concerned with the affidavit of bias and prejudice assignment of error it is

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20. Having raised the question of Judge Boldt's alleged personal bias and prejudice once, DePinto cannot raise it again. Peckham v. Ronrico Corporation, 22 F.2d 605, 607 (C.A. 1).

repeatedly stated that the district judge erred in rulings or that he was not impartial because of such rulings. Because such an argument is not sufficient under the law to support an affidavit of bias and prejudice, appellæedeclines to assume the stance of one defending a district judge on such charges. The filing of the affidavit of bias and prejudice against a visiting district judge based on nothing more that rulings in the case, accompanied be a defective certification from DePinto's counsel, speaks for itself.

DePinto will never be satisfied that he had a fair trial until some jury or some district judge can be found who will rule in his favor. More precisely, the trustee in bankruptcy will never agree that DePinto had a fair trial until a fund is created for the commercial general creditors who, in 1965, extended credit to a corporation, Trosco Land, Inc., on the personal guarantee of DePinto who owned one-third of its stock.

CONCLUSION

The judgment against DePinto, based on a genreal verdict of a jury, should be affirmed. Should the court conclude that the trial court erred in denying the motion for judgment notwithstanding the verdict, then, in that event, and in that event only, appellee contends that he is entitled to a new trial as a matter of right under the Seventh Amendment, Crim v. Handley, 94 U.S. 652, 657, and because the trial court erred in the rejection of certain evidence offered by appellee, and in the admission into evidence of testimony and evidence in the

trial below over the objections of appellee. In the event the court should conclude that the trial court erred in denying the motion of DePinto for judgment notwithstanding the verdict, then, in that event, and in that event only, appellee requests leave of the court to file a memorandum in support of the foregoing grounds upon which he would be entitled to a new trial.

Respectfully submitted,

MC LANE & MC LANE

William Lee McLane

By William Lee McLane
Nola McLane

Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

William Lee McLane

William Lee McLane

APPENDIX A

Appellee disagrees with appellants' Statement of Facts as follows:

(1) The statement at page 5 that a few days prior to October 18, 1957, Kelly told DePinto that the money to purchase his stock was coming from Sabo is incorrect. Kelly testified, as a witness for DePinto, that he never learned that Sabo was in the picture or knew the name Sabo until October 18, 1957 or October 19, 1957. (R.T. 311).

(2) The inference, at pages 5 through 7, that DePinto's resignation was in fact accepted before the adoption of the resolution transferring United's assets to American is based solely on the conclusion which DePinto attempts to draw from the placement of the paragraphs in United's minutes of 4:15 p.m. on October 18, 1957. However, such minutes are unsigned by anyone including the Secretary, and it was stipulated only that DePinto resigned "about 4:15 p.m." on October 18, 1957.

(3) The statement, at page 7, that DePinto did not receive any money, benefit <u>or</u> compensation for his services as a director of United incorrectly states the testimony of Kelly. The latter replied to a leading question on cross-examination from DePinto in the negative when asked if DePinto had "received any money or any <u>benefit</u> whatever <u>in compensation</u> for his services as a

director of United incorrectly states the testimony of Kelly. The latter replied "No" to a leading question on cross-examination from DePinto which asked if DePinto had "received any money or benefit whatsoever in compensation for his services as a ditector." (R.T. 314). It will be remembered that DePinto in the companion appeal is arguing that the community got no benefit from his services as a director of United. Thus, it is important to note the above discrepancy and the source of the testimony.

(4) The recitation of the October 18, 1957 American minutes, at page 7, is not in the proper chronological order. Those minutes were for a 3:30 p.m. meeting of American's directors which was held prior to the 4:00 p.m. meeting of United's directors and the 4:15 p.m. meeting of United's directors at which United accepted the 3:30 p.m. offer of American to transfer 30,800 shares of its stock to United for $308,000 of United's assets. (T.R. 117-126). Thus, the 3:30 p.m. minutes set the pattern rather than vice versa.

(5) The reference at page 8 to Heineman's testimony is incorrect. Heineman testified he prepared the drafts for Exhibits 5-G and 5-H rather than the minutes themselves. (R.T. 416, 424, 449).

(6) With reference to page 8, it needs to be added that at the meeting among the attorneys from three separate law offices held at the offices of Jennings, Salmon, Strauss & Trask, no one represented

United. The Salmon firm represented Kelly. (R.T. 441). Heineman represented Croydon. (R.T. 466). Goss represented American. (R. T. 476).

(7) Again, with reference to page 8, it should be noted that Heineman did have "legal misgivings" about the transaction. He testified that the transaction as it went through was illegal, and that he had told counsel for DePinto that it was illegal. (R.T. 455).

(8) The testiomny referred to at page 9 that the outsiders were "top people" was that of Kelly, the man who got the $308,000 of United's assets by turning the company over to them. (R.T. 306, 309).

(9) The reference at page 9 to the reputation of Mr. Heineman, who represented Croydon and earned a $9,057.28 commission on the sale of Kelly's stock to American, is not relevant to DePinto's negligence or breach of fiduciary duty.

(10) The same is true of the reputation of the members of the firm which represented Kelly, that is, the reputations of Salmon, Campbell and Glenn who are mentioned at page 9.

No. 20553

In the

United States Court of Appeals

For the Ninth Circuit

ANGUS J. DEPINTO and MARGARET F. DEPINTO,
Appellants,

and

JAMES P. DONOHUE, as Trustee in Bankruptcy of the Estate of Angus J. DePinto,
Intervenor-Appellant,

vs.

PROVIDENT SECURITY LIFE INSURANCE COMPANY, and ALBERT J. DOIG,
Appellees.

Reply Brief of Appellants, Angus J. and Margaret F. DePinto, and Intervenor-Appellant, James P. Donohue

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Preface

Appellees' gratuitous statements that, "the DePinto marital community is hopelessly insolvent", and that the Trustee in Bankruptcy is the "real party in interest here", are erroneous. Counsel for appellees have the unfortunate proclivity of going outside the record. In so doing, they overlook the fact that, if the judgment herein is set aside, the only substantial liabilities which the DePinto Estate will face are promissory notes and guaranties,

co-signed by one or more individuals, and the bulk of which are secured by mortgages upon the property of third parties. It is anticipated that the ultimate liabilities of the DePinto estate will be substantially less than the total value of the assets. Under the circumstances, the reversal of this action is of vital interest to DePinto.

Argument

1.

VERDICT NOT SUPPORTED BY THE EVIDENCE

(a) Liability.

We are not unfamiliar with the rule that the verdict of a jury will not be set aside if there is substantial evidence to support it. In the case at Bar, we presume that this Court will apply that rule, but will also adopt the attitude of the Supreme Court of the United States expressed in *Mortenson v. United States,* 322 U.S. 369, 64 S.Ct. 1037, 88 L.Ed. 1331:

> "But we have never hesitated to examine a record to determine whether there was any competent and substantial evidence fairly tending to support the verdict."

Such attitude was expressed by the Supreme Court of the State of Arizona in *Hansen v. Oakley,* 76 Ariz. 307, 263 P.2d 807, 808:

> "On the other hand, if the evidence is not in conflict the only issue is whether the trial court properly applied the law to the facts. The rule is well settled that we are not bound by the conclusions of the trial court or jury, but are at liberty to draw our own legal conclusions from the admitted facts. See Sanders v. Brown, 73 Ariz. 116, 238 P.2d 941, and cases therein cited."

Our position is quite clear. After the members of the Niesz group were elected to the Board of Directors of United, they caused assets of United to be exchanged for American stock.

DePinto did not participate in this transaction, directly or indirectly. Irrespective of DePinto's failure to investigate the antecedents of the members of the Niesz group, he cannot be held responsible for their acts, for the reason that they were reputable business and professional men; there was no reason for him to believe that they were irresponsible or untrustworthy men who would not be restrained by any scruples from "looting" United. DePinto's concurrence in the election of the Niesz group to the Board of Directors of United cannot be considered negligence and, as a matter of law, it cannot be considered as a proximate cause of the transaction complained of; the intervening conduct of the Niesz group was the proximate cause. *Salt River Valley Water Users' Association v. Cornum*, 49 Ariz. 1, 63 P.2d 639. In that case, the Supreme Court of Arizona very clearly stated the rule with respect to proximate cause, and set aside the verdict of a jury because the Court found, as a matter of law, that there was no causal connection between defendant's negligence and the injury sustained by plaintiff. And, in *Shafer v. Mountain States Tel. & Tel. Co.*, 335 F.2d 932 (9th Cir. 1964), this Court affirmed a judgment of the District Court of Arizona based upon the granting of plaintiff's motion for a directed verdict. This Court decided that, as a matter of law, defendant's violation of a regulation of the Arizona Corporation Commission did not constitute the proximate cause of an injury to plaintiff.

Rather than attempting to explain how DePinto's inattention to the affairs of United, prior to October 1957, may be considered as a proximate cause of the transaction which occurred on October 18 of that year, appellees now adopt the tactic of stating that DePinto, by directing his argument "only to one of the eight acts or claims of negligence and breach of fiduciary duty which were submitted to the jury", has, therefore, conceded that the verdict is supported by evidence with respect to such other alleged claims of negligence. In the face of our argument that the trial Court erred

in admitting evidence of the facts and circumstances unrelated to the transaction of October 18, 1957 (Appellant's Brief, page 27), and our argument that the trial Court erred in charging the jury with respect to alleged acts of negligence having nothing to do with the transaction of October 18, 1957 (Appellant's Brief, page 37), appellees' contention just doesn't make any sense.

In opposition to our argument that the jury was not warranted in finding a causal relationship between the conduct of DePinto prior to October 18, 1957, and the transaction of that date, and our contention that the trial Court erred in admitting evidence of such conduct, appellees say that, under the terms of the pretrial order, the pleadings passed out of the case, and that, therefore, they were entitled to have the jury consider all of the claims (together with evidence in support thereof) included in the pretrial order. They further say that appellant is not now in a position to complain about the matter because appellant did not assign, as error, the entry of the pretrial order by the lower Court. Appellees completely ignore the fact that the trial Court, in effect, modified the pretrial order by specifically excluding, from any further consideration in the case, the "claims" based upon the conduct of DePinto and the other defendants prior to October 18, 1957. At pages 158 and 159 of the Reporter's Transcript, we find:

> "MR. JENCKES: I am not quite sure that I understood; is the $177.000.00 claim in effect being withdrawn? I am not clear about that.
>
> "THE COURT: I am striking it. *I am striking it from further consideration in the presentation of the case at this time.*
>
> "You people yesterday were vigorously, all of you, asserting that that element of the case was not a proper one, and urging me to dismiss it from consideration at this time.
>
> "MR. JENCKES: I am not quarreling with your Honor. I wanted to be clear. *But as I understand, if this matter goes to trial, it would not at any time during the trial be brought up, is that right?*

"THE COURT: That is correct. You and your associates yesterday made the position that somehow you would be prejudiced by reference to this, and I am going to delete that possibility of prejudice by directing now that *no part of the $177,000.00 element of claim shall be referred to in any way or considered or further adjudicated in this proceedings.*" (Emphasis supplied.)

(b) Damages.

Appellees' argument anent the question of damages is, apparently, predicated upon the assumption that the burden was upon DePinto to prove that United was not damaged to the extent of $314,794.19, by the transfer of certain of its assets to American in exchange for American stock. Appellees state: "If he (DePinto) had evidence that the bonds, mortgages and notes were not worth $314,794.19, along with the $166,498.66, in cash, it would have been an easy matter to place such evidence before the jury." (Appellees' Brief, page 49). It is, of course, elementary that the burden was upon appellees to prove the allegations of their complaint, including the amount of damage, if any, suffered by United as a result of the transaction of October 18, 1957. According to the instructions of the trial Court, the jury was required to fix the damages by deducting from the "value of the assets transferred to Kelly", the value of the American stock received by United in exchange. (R.T. 587-588) Appellees argue that the jury had before it evidence from which such determination could be made, because:

> *First*, such assets "were $166,498.66, of cash, $60,668.65, in mortgages, bonds and accrued interest, and $87,626.88, in a promissory note and accrued interest."

So far as is disclosed by the evidence, the mortgages, bonds, and promissory notes could have been completely valueless. The only evidence bearing on the question discloses that the $86,000 note of United Finance Corporation was not an "admitted asset"

and that, as a result thereof, United was already in a deficit condition on October 17, 1957. (R.T. 268, 272)

> "*Second*, since few taxpayers ever pay more federal income tax than is necessary, it is significant that Kelly after consulting with tax counsel filed a federal income tax return reporting $308,000 of the assets * * * as having a fair market value of $308,000."

Kelly did report receiving assets of $308,000, however, he did not purport to say that they had a "fair market value" of $308,000. Needless to say, the manner in which Kelly treated the assets in his income tax return would not be binding on DePinto and could not form the basis of a jury finding as to the value thereof.

> "*Third*, the Insurance Department of Arizona valued them at $308,000 after a three and a half month examination and audit."

The Insurance Department of Arizona did no such thing.

> "*Fourth*, the purchaser American reported its cost at $308,000 on its books and records."

The $308,000 placed on the books of American represented the par value of the 30,800 shares of its stock issued to United in exchange for the assets. The book figure does not purport to represent "fair market value".

> "*Fifth*, DePinto stipulated to the $308,000 in assets in the pretrial order of March 1960, made no reservation therein that such amounts did not represent fair market value, and added therein that, as to him, there were no issues of any material fact."

DePinto did not stipulate that said assets have a "fair market value" of $308,000. The stipulation concerned only the face or nominal value of such assets.

We respectfully submit that there is no testimony whatsoever in the record, either oral or written, having any probative force

as to the "fair market value" of the assets transferred by United to American or as to the "fair Market value" of the 30,800 shares of American stock received by United. On the basis of the record, it was an impossibility for the jury even to make an intelligent guess as to the damage (if any) sustained by United as a result of the transaction of October 18, 1957. Appellees failed completely to carry the burden of proving the amount of damage, if any, sustained by United.

2.

ERRORS IN ADMISSION OF EVIDENCE

(a) Facts and Circumstances Unrelated to Transaction of October 18, 1957.

Appellees contend that DePinto is precluded from claiming error in the admission or rejection of evidence because of DePinto's failure to comply with Rule 18(d) of this Court, reading:

> "When the error alleged is to the admission or rejection of evidence the specification shall quote the grounds urged at the trial for the objection and the full substance of the evidence admitted or rejected, and refer to the page number in the printed or typewritten transcript where the same may be found."

We respectfully submit that we have complied with this Court's rule by setting forth, in Appendix "A" to our Opening Brief, the full substance of the evidence objected to, together with a quotation of the specific objections, and by setting forth, in Appendix "B", the full substance of the rejected evidence and a quotation of the objections interposed thereto. This material was placed in the appendix for the reason that page limitations would not permit its inclusion in the Brief proper.

Much of the evidence to which we objected is set forth by appellees in their Brief at pages 5 to 10, under the heading, "The Facts". Referring to those pages, we ask how did DePinto's association with Life Underwriters, Inc. in 1952 have any relation to

the transaction of October 18, 1957? What significance was the preparation of a prospectus for the sale of United stock which mentioned DePinto as a director of Life Underwriters, Inc.? How could the meeting of March 29, 1955 (when DePinto was not a director of United) have had any remote relationship to the transaction of October 18, 1957? How were directors' meetings of November 15, 1955, June 22, 1956, July 18, 1956 and February 19, 1957, relevant to the transaction of October 18, 1957? How was evidence of such facts relevant or material to any issue in the case in the face of the trial Court's ruling:

> "I will delete that entire element of claim from the balance of the trial. In other words, the defendants will be relieved from having to defend against the claims asserted in the $177,000.00 category. * * * and I am going to delete that possibility of prejudice by directing now that *no part of the $177,000.00 element of claim shall be referred to in any way or considered or further adjudicated in this proceeding.*" (Emphasis supplied.) (R.T. 158-159)

(b) Evidence re Damages.

We believe that our objection, with respect to the report of an examination of the affairs of United made by Guy L. Hammett, an Examiner for the Insurance Department of the State of Arizona, during the year 1958, is fully supported by *Olender v. United States*, 210 F.2d 795 (9th Cir. 1954), cited in our Opening Brief. Contrary to appellees' suggestion, the report is not the sort of document which is admissible under the Federal Business Records Act, 28 U.S.C.A. § 1732. In the case of *LaPorte v. United States*, 300 F.2d 878 (9th Cir. 1962), this Court had this to say about Form 153, prepared by an employee of the Selective Service Board:

> "Mr. Hingston's testimony, plus the whole interrelated content of the Selective Service file, established that Form 153 was completed in the routine day-to-day operations of the Local Board and the Department of Charities. It was precisely the kind of *contemporaneous record of events*, sys-

> tematically prepared by an agency for its own use and relied upon by it in the performance of its functions, which experience has shown to be trustworthy, and which therefore falls within the purpose and scope of the business records exception to the hearsay rule codified in Section 1732." (Emphasis supplied.)

Obviously, the report of Hammett was, in no sense, a "contemporaneous record of events, systematically prepared by an agency for its own use".

Not only was the Kelly income tax return of 1957 pure and unadulterated hearsay, it was irrelevant and immaterial to any issue in the case.

With respect to the testimony of the witness Hammett, it is true that, because of his physical condition, DePinto agreed that appellees could offer his testimony which was adduced at the original trial. DePinto did not agree that such testimony was competent, relevant or material. In large part, Hammett's testimony was pure hearsay.

3.

ERRORS IN REJECTION OF EVIDENCE

Appellees take the anomalous position of arguing that DePinto's conduct from the year 1952 to October 1957, in relation to United and in relation to Life Underwriters, Inc., a stranger to this action, was properly placed before the jury, but that the conduct of the members of the Niesz group, in relation to the transaction of October 18, 1957, was not admissible. The Court will bear in mind that, in the original trial of this action, the defendants were exculpated of charges of fraud in connection with the transaction of October 18, 1957, and that no such charges were made in appellees' amended complaints or in the pretrial order. Under the circumstances, it is obvious that DePinto cannot be held responsible for the acts of the Niesz group, unless the members of that group

acted in a negligent manner. It was impossible for the jury to intelligently appraise the conduct of the Niesz group in the absence of knowledge of their good faith efforts to create a holding company (American), and to acquire Arizona insurance companies in a proper and legal manner. Appellees sprinkle through their Brief the charge that members of the Niesz group were "looters" and had the purpose and design of "looting" United. This is the picture that appellees painted to the jury and DePinto was undoubtedly convicted of guilt by association. Appellees' contention that "the evidence respecting the 'plan' (for securing mortgages) takes on an Alice In Wonderland aura when it is viewed from a distance" becomes pure sophistry when viewed in the light of Gregory's testimony that Mr. Bushnell, the Arizona Director of Insurance, approved the merger which was implemented by exactly the same plan of acquiring mortgages under cerificates of contribution which the Niesz group thought they had arranged. (R.T. 525-537) Gregory's testimony was excluded by the trial Court. (R.T. 537)

4.

ERRORS IN CHARGE TO JURY

Appellees' argument with respect to our assignments of error by the trial Court in instructing the jury indicate that appellees misconceive the thrust of our argument. We start with the proposition that the trial Court erred in submiting any issue of fact to the jury, for the reason that, as a matter of law, the acts or omissions of DePinto were not the proximate cause of any loss or damage to United. We then go to the next step: if this Court should conclude that the trial Court was justified in submitting to the jury the issue of whether or not defendants' participation in the election of the Niesz group to the Board of Directors of United was a proximate cause of loss or damage to United as a result of the transaction of October 18, 1957, the Trial Court,

nevertheless, erred in permitting the jury to find that the alleged negligent conduct of DePinto, unrelated to the transaction of October 18, 1957, was a proximate cause of loss or damage to United. If a complaint clearly charges defendant with three different acts of negligence alleged to have proximately caused an injury, it is elementary that the Court should not submit to the jury the issue of proximate cause with respect to acts of negligence numbers 2 and 3 if, as a matter of law, the Court determines that there is no causal relationship between such acts of negligence and the injury.

In this case, we strenuously and repeatedly objected to evidence of DePinto's conduct, having no causal relationship to the transaction of October 18, 1957, and objected to the Court giving instructions which permitted the jury to find such causal relationship. As the result of the brushing aside of our objections by the trial Court, the jury was led to believe that they were at liberty to find a causal relationship between the transaction of October 18, 1957 and the conduct of DePinto having nothing whatsoever to do with that transaction. In the light of *Butane Corporation v. Kirby*, 66 Ariz. 272, 187 P.2d 325 and *Alires v. Southern Pacific Co.*, 93 Ariz. 97, 378 P.2d 1913, cited in our Opening Brief, the instructions of the trial Court, of which we complain, constitute reversible error.

5.

ERRORS IN FAILING TO CHARGE JURY AS REQUESTED

We can add little to our Opening Brief argument that the trial Court erred in failing to charge the jury as requested by DePinto. It is submitted that, if our view of the evidence in this case, and the law applicable thereto, is correct, then DePinto was entitled to have the Judge instruct the jury as requested.

6.

ERRORS WITH RESPECT TO DELIBERATIONS OF JURY

In response to our argument that the trial Judge erred in answering certain questions presented to him by the jury during their deliberations, appellees say: "Of the several attacks which have been made by appellant DePinto on the integrity and fairness of the visiting district Judge who heard the instant case, none has been more unfair or grossly misleading than the innuendo, implications, inference, and direct statements contained in the argument that the district court prejudiced appellant DePinto by the manner and substance of his answer to a communication from the jury. * * * * these attacks are endemic to appellant DePinto's conduct of his defense here, * * * *" (Appellees' Brief, page 81) We are confident that this Court will not decide this case on the basis of appellees' appraisal of the conduct of DePinto's counsel. We deem it appropriate to reiterate that we have never made an attack upon the integrity of the trial Judge. We do not, however, withdraw from our position that DePinto did not receive a fair trial. We submit that, when the trial Judge advised the jury that "the three items of claimed damage" were the cash, promissory notes, mortgages, bonds and accrued interest, aggregating $314,-794.19, this was an invitation to the jury to bring in a verdict in that exact amount (which the jury did), without giving consideration to the value of such items, and without giving consideration to any reduction in that amount to the extent of the value of the 30,800 shares of American stock received by United in exchange. This was a radical departure from the formal instructions of the Court. (R.T. 588) Irrespective of our failure to make proper objection to the Court's informal instructions to the jury, the instruction adverted to was clearly erroneous and extremely prejudicial to DePinto. Under the circumstances, this Court is entitled to take cognizance thereof. *Michie v. Calhoun,* 85 Ariz. 270, 336 P.2d 370.

7.

JUDGMENT EXCESSIVE

(a) Cancellation of Stock.

Appellees, again, go outside of the record to discuss matters with respect to the DePinto bankruptcy. Even appellees should realize that the judgment entered herein was entered prior to bankruptcy. The facts and circumstances surrounding the bankruptcy are not germane to any issue in this case. The authorities to which we have directed the Court's attention in our Opening Brief disclose (without dissent so far as we can discover) two simple rules of equity and fair play:

> (1) In a stockholders' derivative action against a number of wrongdoers, a wrongdoer will not be entitled to participate in a recovery made on behalf of the corporation against another wrongdoer.
>
> (2) In a stockholders' derivative action, the stockholders who will be benefited by a recovery are not entitled to receive more than that portion of the recovery which the number of shares of stock held by them bears to the total number of shares outstanding.

Appellees do not challenge the fact that the right of American and the Duhames (defendants in this case) to share in any judgment rendered against DePinto, or against any other of the defendants, was foreclosed by their surrender of an aggregate of 42,548 shares of United Stock. Under the circumstances, can it be reasonably argued that DePinto should be required to pay to the holders of the balance of the United stock (certificates of participation under the merger agreement) not only the amount of their damage, but also the amount which American and Duhame were damaged. As a result of the transaction of October 18, 1957, United was alleged to have been damaged $314,794.19. This amounts to $3.15 for each of the 100,000 shares of stock outstanding. If the holders of 50,452 shares of United stock

(certificates of participation) are to share in a judgment against DePinto of $314,794.19, they will, then, receive $5.50 per share of stock. The fact that their recovery will be reduced by appellees' attorneys' fees is immaterial. In no event, would such fees be recoverable. Again, we pose the somewhat naive question, would DePinto still have to pay $314,794.19, to the holder of one share of stock, if all of the other 99,999 shares had been cancelled?

Appellees, again, indulge in their practice of going outside the record when they refer to the fact that: "There are two pending lawsuits in the U. S. District Court for the District of Arizona in which claims are being made against United and Provident by former policy holders of United, and in which Provident has denied it assumed liability of the type asserted therein. *Walker v. Provident Security Life Insurace Co.,* Civ. #4069, and *Mauser v. Provident Security Life Insurance Co.,* Civ. #4070. These claims total $119,099.37 and they cannot be satisfied if sustained from Provident Security Life Insurance Co., even if Provident's disavowal of assumption thereof is rejected. Further, the terms of the merger agreement between United and Provident permit the latter to deduct from the judgment here any proper charges against said recovery." If this Court believes it is proper to follow appellees outside the record, we must then point out that the above-mentioned lawsuits were filed on behalf of the plaintiff's therein by McLane & McLane, attorneys for appellee Doig herein on February 23, 1962. The complaints allege that the plaintiffs purchased single premium annuities from United. The premiums were, in great part, paid by loans against the annuity policies. At the time of the purchase, the plaintiffs and United believed that plaintiffs would be entitled to federal income tax deductions to the extent of the interest paid on the policy loans. At a later date, it was decided by the Tax Court that such interest payments are not deductible. The plaintiffs claim that they are entitled to rescind

their annuity contracts, and recover the cash premiums paid, on the grounds of a mutual mistake of law, or because of misrepresentations of law by United agents. We submit that the actions are frivolous. Counsel for Doig are, of course, in the anomalous position of attempting, in this action, to recover a fund for the benefit of the stockholders of United and, at the same time, prosecute other actions which, if successful, will reduce that fund. The fact remains that there is no suggestion in the record in this case that the proceeds of a judgment herein will be reduced five cents by any claims of third parties.

(b) Credit for Payment by "Joint Tortfeasor".

By his original complaint and amended complaint filed in this action, Gorsuch charged DePinto and Duhame with negligence and breach of their fiduciary duties as directors of United, which allegedly caused damage to United. As alleged joint tortfeasors, DePinto and Duhame were charged with the same acts of negligence. After the first reversal, amended complaints were filed by Doig and Provident wherein DePinto and Duhame were charged with negligence and breach of fiduciary duty with respect to the transaction of October 18, 1957. Appellees do not contend that DePinto and Duhame were not proceeded against herein as joint tortfeasors, or that the claims made against them were not identical. It is not disputed that the Duhame Executors paid $100,000 for a covenant not to sue—a covenant which insulates the Duhame Executors against any and all claims which were, at any time, made herein against Duhame and his Executors (and against DePinto). Under these circumstances, it is the law of the State of Arizona that any judgment rendered herein against DePinto must be reduced by the amount of $100,000.

The rule that a joint tortfeasor is entitled to credit for any sums paid by another joint tortfeasor in consideration of a covenant not to sue is not peculiar to Arizona. In *McNair v. Goodwin,*

136 S.E.2d 218 (N.C. 1964), the Supreme Court of North Carolina stated the rule:

> "But a covenant not to sue does not release and extinguish the cause of action and the cause of action may be maintained against the remaining tort-feasors notwithstanding the covenant. Simpson v. Plyler, supra; Slade v. Sherrod, 175 N.C. 346, 95 S.E. 557. The remaining tort-feasors are entitled, however, to have the amount paid for the covenant credited *on any judgment thereafter obtained against them by the injured party.* Ramsey v. Camp, 254 N.C. 443, 119 S.E.2d 209, 94 A.L.R.2d 348; Holland v. Southern Public Utilities Co., 208 N.C. 289, 180 S.E. 592." (Emphasis supplied.)

See also, *Schumacher v. Rosenthal,* 226 F.2d 946 (7th Cir. 1955) and *Bal Theatre Corp. v. Paramount Film Distributing Corp.,* 206 F.Supp. 708, 714 (U.S.D.C.N.D.Cal. 1962).

Even if the appellees and the Duhame Executors had agreed that the $100,000 payment was not to be credited upon any judgment rendered against DePinto, such agreement would not deprive DePinto of his right to the credit. We quote from *Restatement of the Law, Torts,* Sec. 885, page 463: "Payments made by one of the tortfeasors on account of the tort either before or after judgment diminish the claim of an injured person against all others responsible for the same harm. This is true although it was agreed between payor and the injured person that the payment was to have no effect upon the claims against the other."

(c) Interest.

In response to our claim that the trial Court erred in allowing interest from October 18, 1957, rather than from the date of the judgment, counsel refer to *Zeckendorf v. Steinfeld,* 15 Ariz. 334, 138 P. 1044. That case originated in the territorial days in the District Court of Pima County. The Supreme Court of Arizona affirmed a judgment which included 6% interest on the amounts

recovered, "from the date of the wrongful conversion of such sums by Steinfeld". The *Zeckendorf* case has no application here for it involved a liquidated claim and did not purport to reflect the law of the State of Arizona. The Supreme Court said, in reaching its conclusion: "We think this was 'according to right and justice and the laws of the United States,' and in conformity with the opinion of the Supreme Court (of the United States)." The Arizona case of *Desert Waters, Inc. v. Superior Court,* 91 Ariz. 163, 370 P.2d 652, also relied upon by appellees, has no remote application to the case at Bar. That case involved the condemnation of a water utility by the City of Tucson. A.R.S. Section 12-1123B reads: "If an order is made letting the plaintiff into possession prior to final judgment, the compensation and damages awarded shall draw legal interest from the date of the order."

It will be borne in mind that this action did not present a claim against DePinto for stealing or conversion; and certainly not for the stealing of cash or securities having a fixed value. The trial Court properly instructed the jury that, in arriving at the amount of damages sustained by United, they should determine the value of the assets transferred to American and deduct therefrom the value of the 30,800 shares of American stock received in exchange. (R.T. 588) If the trial Judge had thought that the damages were not unliquidated, then what purpose was served by submitting the issue of damages to the jury.

Appellees argue that this is an equitable action and that, therefore, the matter of determining the date from which interest shall run is within the discretion of the trial Court. We submit that there is no exception to the rule in Arizona that interest on an unliquidated claim (in law or equity) runs from the date of judgment. Furthermore, this Court held, in *DePinto v. Provident Security Life Insurance Co.*, 323 F.2d 826 (9th Cir. 1963), that the claim being asserted on behalf of United is a common law action for negligence—an action at law.

(d) Discharge of Joint Tortfeasors.

Appellees say that the consent judgments which were entered in the amount of $308,000, against James E. Kelly, L. N. Kelly, Nina Dunn and J. L. Jenkins "is just like any other judgment" and did not constitute a release of all claims in excess of that amount which would have the effect of releasing all other joint tortfeasors. Appellees do not challenge the rule that "in an action against joint tortfeasors, judgment cannot be entered against any one defendant for an amount exceeding that entered against a co-defendant." They do not direct the Court's attention to any authorities which derogate from those cited in our Opening Brief.

8.

ERROR IN SEVERING CLAIM

In the original trial of this action, there were 14 defendants. Eight of the other defendants testified at the trial and were subject to *cross-examination* by DePinto. The jury rendered verdicts against Niesz, Sabo, Pegram and Landoe and in favor of DePinto and Duhame. Because all of the parties were before the Court in the initial trial, and because the jury heard their testimony—tested and refined by cross-examination—the jury was able to make an intelligent determination as to the persons who should be held responsible for the transaction of October 18, 1957. In the last trial, the jury, no doubt, felt they had a duty to hold someone responsible for the transaction of October 18, 1957. The only "someone" upon whom they could place responsibility for such transaction was DePinto. Under the circumstances, DePinto had less chance of exculpation at the hands of the jury than the proverbial snowball.

9.

DENIAL OF FAIR TRIAL

In our Opening Brief, we stated: "There are numerous decisions to the effect that an affidavit of bias or prejudice must be

based on something other than rulings against a litigant." Appellees have directed the Court's attention to those decisions. We submit, however, that the authorities cited in our Opening Brief amply support the conclusion that, upon the record in this case, the affidavit was proper, it was timely and invoked the provisions of 28 U.S.C.A. Section 144. Upon the filing of the affidavit, Judge Boldt had no power or authority to proceed further in the action. We, again, quote the language of the Supreme Court (*Re Murchison*, 249 U.S. 133, 99 L.Ed. 942, 75 S.Ct. 623): "A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness".

The judgment of the trial Court must be reversed.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH S. JENCKES, JR.
Joseph S. Jenckes, Jr.

No. 20554

United States
COURT OF APPEALS
for the Ninth Circuit

JOEL C. HERTSCHE, JR., Executor of the Estate of Joel C. Hertsche, Deceased, and JOEL C. HERTSCHE, JR., Transferee of the assets of the Estate of Joel C. Hertsche, Deceased,

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLANTS

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No. 20554

United States
COURT OF APPEALS
for the Ninth Circuit

JOEL C. HERTSCHE, JR., Executor of the Estate of Joel C. Hertsche, Deceased, and JOEL C. HERTSCHE, JR., Transferee of the assets of the Estate of Joel C. Hertsche, Deceased,

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLANTS

OPINION BELOW

The opinion of the District Court (R. 36) is reported at 244 F. Supp. 347.

JURISDICTION

This appeal involves federal estate taxes assessed against the estate of Joel C. Hertsche, deceased, and col-

lected from the appellants by the District Director of Internal Revenue for the District of Oregon (R. 1-2).

A timely federal estate tax return for the estate was filed with the District Director on June 26, 1961 (R. 2). The return was subsequently examined by a representative of the District Director, and, in October, 1963, the executor of the estate received a memorandum of proposed adjustments from the examiner asserting that additional estate taxes were due (R. 3). On or about October 10, 1963, the appellants paid the asserted estate tax deficiency together with interest thereon (R. 3-4).

On January 15, 1964, the appellants filed a claim for refund of the estate taxes and interest paid by them pursuant to the memorandum of proposed adjustments, and for an additional refund of estate taxes previously paid based upon the prospective additional allowable deduction for attorneys' fees and other expenses incurred in prosecuting the claim for refund (R. 4). Under date of June 16, 1964, the appellants received a statutory notice of disallowance in respect to their claim (R. 4).

Within the time provided by Section 6532 of the Internal Revenue Code of 1954, and on July 2, 1964, the appellants brought an action in the United States District Court for the District of Oregon for the recovery of the disputed taxes paid (R. 54). Jurisdiction existed in the District Court under 28 U.S.C., Section 1346(a)(1). Judgment was entered on July 26, 1965 (R. 46). Within 60 days, and on September 22, 1965, the appellants filed their Notice of Appeal (R. 47). Jurisdiction is conferred upon this Court by 28 U.S.C., Section 1291.

QUESTION PRESENTED

Whether the proper date for determining the value of 5,000 shares of stock in National Lead Co., for inclusion in the decedent's gross estate under the alternate valuation provision contained in Section 2032 of the Internal Revenue Code of 1954, is October 25, 1960, the date distribution of the stock from the estate was actually made, or, is October 14, 1960, the date an order authorizing an advance and partial distribution of legacies was entered by the Probate Court.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, and the applicable Treasury Regulations issued thereunder, are set forth in the Appendix, *infra*.

STATEMENT

All material facts were stipulated by the parties and are set forth in the Pretrial Order entered by the District Court (R. 1-6). Exhibits A, B and C were attached to the Pretrial Order and admitted when the Order was filed (R. 7-35). The agreed facts are as follows:

The decedent, Joel C. Hertsche, died testate on March 25, 1960, and shortly thereafter his will was admitted to probate in the Circuit Court of the State of Oregon for the County of Multnomah (R. 2). At the date of his death the decedent was the owner of 7,400 shares of the common stock of National Lead Co. (R. 2).

On October 14, 1960, an "Order for Advance and Partial Distribution of Legacies" was entered by the probate department of the aforesaid court authorizing the executor to distribute certain specific legacies and 5,000 shares of National Lead Co. common stock to the persons entitled to receive said distributions (R. 3). On October 25, 1960, the executor, pursuant to the order, distributed the stock to the residuary legatees under the will by transfer and physical delivery (R. 3). When actual distribution was made the executor was relieved of his fiduciary liability in respect to the stock (R. 3).

The stock was valued on the decedent's estate tax return for inclusion in the gross estate at $79.6875 per share, the mean of its high and low selling prices on October 25, 1960 (R. 3). Upon audit of the return, a deficiency in tax was proposed on the theory that the stock should have been valued at $84.75 per share, its value on October 14, 1960, the date the order authorizing partial distribution was entered by the probate court (R. 3).

The lower court adopted the position of the Internal Revenue Service in its opinion filed June 4, 1965 (R. 36-40). Judgment was entered in favor of the appellants, however, by reason of the court's allowance of a deduction for the attorneys' fees expended in prosecuting the claim (R. 46).

SPECIFICATION OF ERROR

The District Court erred in holding and deciding that the proper date for valuing 5,000 shares of National Lead Co. common stock under the alternate valuation

provision contained in Section 2032 of the Internal Revenue Code of 1954 was October 14, 1960, the date the probate court entered an order authorizing distribution of the stock, rather than October 25, 1960, the date the stock was actually distributed by the estate.

SUMMARY OF ARGUMENT

Section 2032 of the Internal Revenue Code of 1954 provides, in part, that upon the executor's election, the assets includible in a decedent's gross estate may be valued for estate tax purposes as of the date they are distributed to the beneficiaries of the estate. We contend that this means the date of actual distribution, and not some other arbitrarily selected date preceding distribution. The word "distributed" is commonly used and creates no ambiguity. Moreover, it is used repeatedly in other sections of the Internal Revenue Code, wherein it has always been held to mean the actual physical transfer of property. Since the use of the word "distributed" is so commonplace and well understood, there is no need to amplify it by regulation. Moreover, Treasury Regulation 20.2032-1(c), although it purports to merely interpret the statute, actually does far more. It names several other dates wherein the decedent's assets will be *considered* distributed. Thus, by its own language, the regulation is admittedly engaging in more than mere interpretation. It is attempting to actually add words to the statute without authorization by Congress.

Although Treasury Regulations interpreting the internal revenue laws are entitled to great weight, they

should not always be accepted. If they appear to add words to the statute, or are unreasonable in light of the statutory language employed by Congress, and the legislative intent in adopting the statutory provision, they should be stricken by the courts.

ARGUMENT

I

Introduction

In computing the value of the gross estate for federal estate tax purposes, a decedent's assets are normally valued as of the date of his death. This is the long standing general rule provided by Section 2031(a) of the Internal Revenue Code of 1954. Since 1935, however, an alternate valuation provision has been in the tax law which is now contained in Section 2032 of the 1954 Code.

The appellant-executor properly elected to value the decedent's assets for inclusion in his gross estate in accordance with Section 2032. The portion thereof material to this suit is Section 2032(a)(1), *Appendix, infra.*, which provides, in part, that in the case of property distributed within one year after the decedent's death, such property shall be valued *as of the date of distribution.*

The only dispute between the parties involves the value to be ascribed to 5,000 shares of stock in National Lead Co. which the decedent owned at his death, but which were distributed to the residuary legatees under his will within the one year period following his death. The parties are in agreement that the stock was actually

distributed on October 25, 1960, at which time its value per share was $79.6875. This is the date and value used in filing the decedent's estate tax return. The government, however, has taken the position that the date of distribution is not controlling despite the language of the statute, and contends that the proper valuation date is October 14, 1960, the date the probate court entered an "Order for Advance and Partial Distribution of Legacies." In support of its position, the government relies upon its own Treasury Regulation. Section 20.-2032-1(c)(2), *Appendix, infra.*, which purports to prescribe when property is *considered* distributed; namely, upon the first to occur of the following: (1) the entry of an order for distribution; (2) the segregation of the property from the estate so that it is unqualifiedly subject to the demands of the distributee; or (3) the actual paying over or delivery of the property to the distributee.

We contend that this regulation is invalid for the reason that it is an unwarranted extension of the statute, and that it was proper for the appellant-executor to value the 5,000 shares of National Lead Co. stock in accordance with the statute as passed by Congress. In the sections below we will point out why the actual date of distribution is the logical and proper alternate valuation date and discuss the courts' power in respect to the validity of treasury regulations.

II

The 5,000 Shares Distributed Within One Year After the Decedent's Death Should Be Valued As of the Date of Distribution

Perhaps the best reason why the distribution date is the proper alternate valuation date is that the statute says so in clear and unambiguous terms. This statute, presently Section 2032(a)(1) of the Internal Revenue Code of 1954, entered the tax law in 1935 as Section 202 of the Revenue Act of 1935, c. 829, 49 Stat. 1014. In respect to that portion of its language material to this case, it has never been substantively changed. It has always provided that if the alternate valuation method is elected, property distributed within one year after the decedent's death shall be valued *as of the date of distribution.* Neither Section 2032(a)(1) nor any of its predecessors have ever provided that the alternate valuation date should be some other date preceding distribution.

In addition to the plain meaning of the statute, our position is further supported by the intent of Congress in passing the alternate valuation provision. In 1935, due to the 1929 market crash, Congress became concerned with the problem of an estate being valued at a certain figure for tax purposes on the date of the decedent's death and then having its value plunge greatly during its administration with the result that it could be substantially confiscated for taxes. Originally, the House and Senate proposed a special deduction for the amount of shrinkage in the value of an estate between the date

of death and one year after death, or, if the assets were sold or exchanged in the interim, then on the date of sale or exchange. H. Rep. No. 1681, 74th Cong. 1st Sess., 1939-1 (Part 2) Cum. Bull. 642, 649; S. Rep. No. 1240, 74th Cong. 1st Sess., 1939-1 (Part 2) Cum. Bull, 651, 659. Nothing was mentioned at this point in regard to the valuation date to be used in the event assets were distributed to estate beneficiaries during the one year period following the decedent's death.

When the revenue bill reached the House and Senate conference committee, however, the proposed shrinkage deduction was changed to the alternate valuation provision. The change was explained in the report of the conferees as follows (H. Rep. No. 1885, 74th Cong. 1st Sess., 1939-1 (Part 2) Cum. Bull. 660, 663):

> The [senate] amendment also allows an additional deduction, in computing the value of the net estate, of the net shrinkage in value of assets arising from the difference in the aggregate value of assets forming part of the decedent's gross estate on the date of death and the aggregate value of such assets one year thereafter, substituting the date of sale or exchange by the executor in the case of assets sold or exchanged during such 1-year period. In lieu of this provision, the conference action inserts a provision giving the executor an election with respect to the time as of which the property included in the gross estate is to be valued. Under existing law the valuation is made as of the date of death. If the executor exercises the election given him by the conference agreement, all the property included in the estate on the date of death is to be valued as of the date one year after the decedent's

death, except that the value (at the time of distribution, sale, exchange, or other disposition) of property distributed, sold, exchanged, or otherwise disposed of, is taken in lieu of its value as of one year after death. . . .

Following the explanation of the bill, the committee gave the following example of its operation:

A decedent dies owning real estate of the value of $100,000, corporate stock of the value of $60,000, bonds of the value of $20,000, foreign government bonds maturing nine months after date of death of a face value of $10,000, but of a value of $9,550, and cash amounting to $5,000. These values are as of the date of death. The gross estate at date of death amounted, therefore, to $194,550.00. The decedent had debts of $15,000 and the administration expenses were $25,000, which debts and expenses were promptly paid by the executor. The value of the net estate as of date of death was, therefore (after taking off the specific exemption), $114,550. Six months after the decedent's death the executor distributed the bonds to a legatee under the will, at which time they were worth $18,000, and he sold all the corporate stock owned by the decedent for a fair market value of $50,000 in order to raise cash to pay the debts and expenses. The foreign bonds were paid in full at maturity. During the first year after the decedent's death the value of his real estate appreciated $5,000. The executor elects to take advantage of the new provision of the bill. The value will be arrived at in this way:

Assets:	Value.
Real estate (as of one year after death)	$105,000
Corporate stock (as of date of sale)	50,000

Bonds (as of date of distribution)		18,000
Foreign bonds (as of date of disposition, i.e., maturity)		10,000
Cash		5,000
Gross estate		188,000
Deduct:		
Debts	$15,000	
Administration expenses	25,000	
Specific Exemption	40,000	
		80,000
Net estate		$108,000

In the above example it can be seen that the valuation date of the bonds presents a situation similar to the case at bar. The committee quite explicitly demonstrated that the correct alternate valuation date was the distribution date, and made no technical distinction between actual distribution, order for distribution, or segregation or separation of assets. Nor did the committee direct or even suggest that the Treasury should make such a distinction.

It seems clear from an examination of the statute and its legislative history that the drafters of the statute intended that the latest date to be used for alternate valuation should be either one year from the date of the decedent's death or whenever the property was removed from the administration of the estate, whichever occurred the earlier. This is recognized by Treasury Regulation 20.2032-1(c)(1), *supra,* which provides, in part. "The phrase 'distributed, sold, exchanged, or otherwise

disposed of' comprehends all possible ways by which property ceases to form a part of the gross estate."

We submit that in the case at bar the 5,000 shares of National Lead Co. stock did not cease to be a part of the decedent's gross estate merely upon entry of the "Order for Advance and Partial Distribution of Legacies". The order was applied for by the executor and entered by the probate court pursuant to Ore. Rev. Stat. 117.350, which provides:

> 117.350. *Application for distribution of share of realty or personalty.* At any time after the filing of the first semiannual account and the expiration of at least six months from the date of first publication of notice to creditors, and when all uncontested claims filed with the executor or administrator have been paid or are sufficiently secured by a mortgage, or otherwise, but the estate is not in a condition to be finally closed and distributed, the executor or administrator, any heir, devisee, legatee or beneficiary of any trust created by will may apply to the court, by petition, for an order *authorizing* the distribution of a legacy, devise or share of the estate, or of any portion or portions thereof, to the heir, legatee or devisee entitled thereto. (Emphasis supplied).

This provision of Oregon probate law sets forth a means whereby an estate can be partially distributed before a final order directing distribution is entered. It does not direct or require distribution but simply authorizes a partial distribution to be made by the executor. Thus, it is not self executing and its mere entry alone does not operate to divest the assets listed therein from the gross

estate.[1] It is quite different from the final order of distribution usually entered upon the executor's final accounting following which the estate is closed.

Since the drafters of the alternate valuation provision intended that any depreciation in value of the assets of the estate that occurred while they were being administered in probate should, at the election of the executor, be reflected in the valuation of the decedent's gross estate, the government's position set forth in Treasury Regulation 20.2032-1(c)(2) is unduly restrictive and is in conflict with the intent of Congress. We are unable to see any reason why estate assets should be deprived of the estate tax benefits conferred by the alternate valuation provision during the period between entry of the order authorizing distribution and the actual distribution itself. During this period the assets certainly remain part of the estate subject to its administration, and the claims of the heirs, legatees or devisees named in the order continue to be subordinate to claims of others of greater rank, such as creditors of the estate.

As a practical matter, it is possible that the interval between entry of the order and distribution could be substantial in length during which time the economic circumstances that prompted the enactment of the alternate valuation provision in the first place could very well occur.

It is interesting to note that the government would

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[1] Although the order itself in our case appears to be broader than the partial distribution statute, it is clear the order was entered pursuant to that statute.

take a different position in respect to excise taxes resulting from the distribution of the National Lead Co. stock which are imposed by Section 4321 of the Internal Revenue Code of 1954.[2] In a special ruling dated December 23, 1958, found in CCH Excise Tax Reporter transfer binder (1959-60) at paragraph 6388, it is provided that:

> The date the stock certificate is actually distributed and delivered to the legatee, or other proper person, is the time of transfer and the actual value as of that date is the basis for the tax.

This position was reaffirmed by the Internal Revenue Service in another special ruling dated July 30, 1959, which can be found in the source cited above at paragraph 6389. There it is stated that:

> Where stock, the subject of a gift, is delivered by the donor to the donee . . . the day of such physical delivery to the donee is the day for determining the actual value. Likewise, if stock is delivered by an executor or administrator to a legatee, or other person entitled thereto, the day the stock is so delivered by the executor or administrator is the day for computing the actual value for the purpose of the transfer tax.

In our view, these rulings ascribe to the word "distributed" its commonly understood meaning. For this reason we are puzzled as to why the drafters of the estate tax regulations found it necessary to adopt the rather lengthy and involved regulation in question dealing

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[2] Recently repealed by the Excise Tax Reduction Act of 1965, P. L. 89-44, Sec. 401(a).

with alternate valuation.[3]

We anticipate that the government may assert that the word "distributed" is so general that the adoption of Treasury Regulation 20.2032-1(c)(2), purporting to define the term, was a proper exercise of its interpretative function. *Evans* v. *Commissioner*, 264 F.2d 502 (9th Cir. 1959), *rev'd* on other grounds, 364 U.S. 92 (1960). Although we discuss this at greater length in the next section of our brief, we would like to point out here that the regulation in question does not merely attempt to interpret or define the term "distributed" which, if the Treasury had thought it necessary, could easily have been done.[4] It attempts to prescribe that upon the occurrence of one of three possible events, only one of which can reasonably be construed to fall within the normal meaning of the word "distributed", distribution shall be *considered* to have taken place. This is certainly more than an attempt to interpret or clarify; it is an unwarranted attempt to legislate.

As noted above, the word "distributed" is a common one and creates no ambiguity. There is no reason why it should not be given its normal, ordinary meaning. *Grange Insurance Ass'n. of California* v. *Commissioner*, 317 F.2d 222 (9th Cir. 1963). In fact, "distributed" is one of the words most frequently used by the drafters of the Internal Revenue Code.[5]

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[3] The popular or received impact of words furnishes the general rule for the interpretation of public laws. Woolford Realty Co. v. Rose, 286 U.S. 319, 327 (1931).

[4] As illustrated by the excise tax rulings, *supra*.

[5] It was similarly used in the revenue statutes preceding the Internal Revenue Code of 1954.

In subchapters C and K of Chapter 1 of Subtitle A of the Code dealing with corporate distributions and adjustments and with partnerships, respectively, the term "distribution" is used in one form or another in nearly every section pertaining to the transfer of property from a corporation to its shareholders and from a partnership to its partners. Despite the repeated and important usage of the term, the drafters of the Code felt it unnecessary to define it even though they apparently were aware that certain words of art which they used needed definition. See, Sections 317 and 7701 of the 1954 Code. It is also of significance to note that apparently the Treasury did not deem it necessary to explicitly define the term by regulation when used in subchapters C and K. We submit that when the word "distributed" is used in these subchapters and their supporting regulations, it means nothing less than actual distribution. The Supreme Court so held in the early case of *Mason* v. *Routzahn*, 274 U.S. 175 (1927), wherein the government unsuccessfully asserted that the date a dividend was declared should be deemed the distribution date rather than the date of actual payment under a no longer existing statute wherein it was material to determine the date of distribution of a dividend to ascertain the tax rate applicable.

Subchapter J of Chapter 1 of Subtitle A of the Code pertaining to the income taxation of estates and trusts also contains many provisions using the word "distribution" or a derivative thereof. As in the case of subchapters C and K, it is clear that everywhere the term is used the physical act of distribution is what is meant.

Perhaps the best example of this point is contained in Section 661 of the 1954 Code. This section allows a deduction in computing the taxable income of an estate or complex trust for income received during the year which is required to be distributed currently and for any other amounts properly paid, credited or required to be distributed during the year.[6] Questions have arisen under this provision in respect to an item which is not required to be distributed currently as to when a distribution occurred so it could be deemed an amount which has been properly paid or credited.

In *Estate of Bond* v. *United States,* 326 F.2d 999 (Ct. Cl. 1964), the executors of the estate filed an administration account containing a schedule of proposed distribution in 1951. In December of that year, the probate court entered an order finding the account true and directing distribution to the residuary distributee in accordance with the terms of the will. After several appeals which were eventually settled in a judgment, the estate was finally distributed by agreement on October 30, 1952. The executor claimed a deduction in computing the taxable income of the estate for 1951 for an amount paid or credited to a beneficiary under the 1939 Code predecessor of Section 661.[7] His theory apparently was that the order entered in December, 1951, effected a distribution even though actual distribution did not take place until 1952. The Court of Claims held for the government on

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[6] The corresponding income provision in respect to the distributee is Section 662 of the Code.

[7] Section 162(b) and (c) of the Internal Revenue Code of 1939, (26 U.S.C. 1952 ed. Sec. 162), as amended by Section 111 (b) and (c) of the Revenue Act of 1942, c. 619, 56 Stat. 798.

the ground that no amounts were paid, credited or required to be distributed until 1952, when actual distribution occurred. Although the decision in the case must be read in light of its facts, it is important to note that the court's opinion is bottomed on the fact that no actual distribution had taken place until 1952, nor had there been any enforceable order giving the legatees, heirs or beneficiaries a legal right to compel distribution.

Turning to the case at bar, it is interesting to speculate on what would have been the income tax consequences had National Lead Co. paid a dividend subsequent to the entry of the order authorizing partial distribution but before actual distribution was made, assuming actual distribution occurred in the next taxable year. It seems clear that the estate and not the distributee would have been taxed on the dividend in that event since the dividend income was not required to be distributed currently nor was it actually paid or credited. *Kuldall* v. *Commissioner,* 69 F.2d 739 (5th Cir. 1934); *Woolley* v. *Malley,* 30 F.2d 73 (1st Cir. 1929); *Estate of Donnelly,* 31 B.T.A. 577 (1934). Again, actual distribution is the focal point.

We fail to see any reason why the term "distributed" should be given a construction by regulation which is different from its treatment throughout the tax law generally and which is contrary to its commonly understood meaning. Although the Treasury probably thought it was promoting certainty by promulgating the regulation in question, we submit that uncertainty can, and often does, result from such action.

For example, in *Estate of Critchfield,* 32 T.C. 844 (1959), one of the questions before the Tax Court was whether certain stock should be included in the decedent's gross estate at the value on the optional valuation date or on the earlier date upon which the surviving spouse had elected, under local law, to purchase the stock from the estate. The optional valuation date was stipulated by the parties and found by the Court to be the date the stock was actually distributed or transferred to the surviving spouse and not the date on which the probate court entered an order approving the surviving spouse's election to purchase and directing the executor to convey the stock to her. Although the issue before this Court was not involved in *Critchfield,* the case demonstrates that confusion and inconsistency can be generated by an arbitrary regulation that appears to be without any real purpose.

In another context, we might pause to consider how the phrase "at the date of distribution" is to be interpreted in connection with the recently issued Revenue Procedure 64-19, 1964-1 Cum. Bull. (Part I) 682, which is of great importance in the state planning field. The ruling states the position of the Internal Revenue Service relative to allowance of the marital deduction[8] in cases where there is some uncertainty as to the ultimate distribution to be made in payment of a pecuniary bequest or transfer in trust where the governing instrument provides that the executor or trustee may satisfy bequests in kind with assets at their value as finally determined for federal estate tax purposes. In

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[8] Section 2056 of the Internal Revenue Code of 1954.

nearly every section of the ruling a key date is the "date of distribution" which is not defined. Material differences can result depending upon whether the distribution date is considered to be when actual distribution occurs or when the order authorizing or directing distribution is entered. Although one would think actual distribution is what was meant by the Service, the existence of regulations such as Treasury Regulation 20.2032-1(c)(2) creates doubt and uncertainty.

III

A Treasury Regulation Which Arbitrarily Attempts To Enlarge the Scope of a Statute Is Invalid

Although we believe that our position is firmly supported by the statute, we recognize that we are confronted by a long standing Treasury Department regulation to the contrary.[9] Clearly, this fact impresses the lower court (R. 38-39).

In most instances, we would admit that regulations drafted by the governmental agency charged with administration of the law should be treated with great respect. For example, had the regulation in question read like the excise tax rulings, discussed above, no valid objection could be made. If this had been the case, the regulation would simply have constituted a reasonable interpretation of a key word used in the statute. As such, it would have served a proper administrative function. We submit, however, that the regulation, as written, attempts to do far more, and goes beyond the Con-

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[9] Treasury Regulation 20.2032-1(c), *Appendix, infra.*

gressional authority granted the Treasury Department for the adoption of regulations.

The Treasury's regulation-making authority is derived from Section 7805(a) of the Internal Revenue Code of 1954, which allows it to prescribe all "*needful* rules and regulations" for the enforcement of the internal revenue laws. As a general proposition, regulations adopted under this authority are entitled to substantial weight.[10] A number of rationales have developed in support of the weight normally given to the Treasury's interpretative regulations.

One of the most frequently mentioned principles is that of legislative reenactment—the theory being that Congress is aware of the Treasury's interpretative regulations and is tacitly approving of them when it reenacts a statute without change. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U.S. 110 (1939); *Cammarano* v. *United States*, 358 U.S. 498 (1959). The lower court in the instant case cited this principle in its opinion (R. 39).

Another theory often used is that of contemporaneous construction. Under this doctrine, regulations issued contemporaneously with the enactment of a statute are presumed to represent the general understanding of the meaning of the statute and of legislative intent. *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496 (1948); *Fawcus Machine Co.* v. *United States*, 282 U.S. 375 (1931). This theory was also mentioned by the lower court (R. 39).

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[10] See, Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity*, 43 Taxes 756, 760 (1965).

We submit that these principles, based upon unsupported assumptions of fact, are no substitute for careful scrutiny of a regulation in light of the language employed in the statute and the purpose for which it was enacted. This has been recognized by many courts. The Supreme Court in the early case of *Manhatten General Equipment Co.* v. *Commissioner*, 297 U.S. 129 (1936), stated (p. 134):

> The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law, for no such power can be delegated by Congress, but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute is a mere nullity.

More recently, in *United States* v. *Calamaro,* 354 U.S. 351 (1957), the Court held a wagering tax regulation invalid, stating (p. 358-359):

> . . . In light of the above discussion, we cannot but regard this Treasury Regulation as no more than an attempted addition to the statute of something which is not there. As such the regulation can furnish no sustenance to the statute.

Moreover, in *Mitchell* v. *Commissioner,* 300 F.2d 533 (4th Cir. 1962), a Treasury regulation was stricken despite an argument put forth by the government which included both the reenactment and the contemporaneous construction theories.[11]

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[11] The *Mitchell* decision was approved and followed by the Court of Appeals for the Tenth Circuit in *United States* v. *Rothenberg,* 350 F.2d 319 (1965).

Our point in respect to the validity of the Treasury's interpretative regulations is best summed up by the following language from the opinion in *Busey* v. *Deshler Hotel Co.,* 130 F.2d 187 (6th Cir. 1942) at p. 190:

> To become binding, interpretative regulations must be reasonable and in furtherance of the intention of Congress, as evidenced by its Acts. An arbitrary regulation of the Commissioner of Internal Revenue is not enforceable. Where the language of a taxing statute is plain and unambiguous, there is no occasion for resort to interpretative promulgations of the Treasury Department. Neither the administrative officers nor the courts may supply omissions or enlarge the scope of the state. See Iselin v. United States, 270 U.S. 245, 250, 251, 46 S. Ct. 248, 70 L. Ed. 566.

This Court in *Fisher Flouring Mills Co.* v. *United States,* 270 F.2d 27 (9th Cir. 1959) put it as follows (p. 30):

> . . . It seems clear that the Supreme Court has not abandoned the axiom that the legislative will must be ascertained from the text of the statute if the words are clear and plain and the whole enactment internally cohesive. . . . In virtue of legislative selectivity of objects of taxation, an act levying imposts should not be construed if unambiguous even by the use of adventitious aids ordinarily available.

As we have pointed out, Treasury Regulation 20.2032-1(c)(2) is not only out of harmony with Section 2032, it is out of harmony with the entire Code as well as other administrative rulings. Moreover, there appears to be no reasonable need for adopting the regu-

lation which patently enlarges the scope of the statute. Thus, we urge that the regulation is plainly invalid and should not be given the weight by this Court normally accorded to consistent, meaningful regulations which have been adopted to interpret or clarify a statutory provision which needs it.

We might further add that striking down a portion of the regulations promulgated under Section 2032 is not without precedent. Shortly after the adoption by Congress of the alternate valuation provision, the Treasury issued Article 11 of Regulation 80 (1937 ed.), the predecessor to Treasury Regulation 20.2032-1, part of which required inclusion in the gross estate of income earned during the year following the date of death when the alternate valuation date was elected. In *Maass* v. *Higgins,* 312 U.S. 443 (1941), this aspect of the regulation was held to be invalid, the Court stating (p. 447):

> . . . the petitioners insist that the Government's position is unreal and artificial; that it does not comport either with economic theory or business practice; and that the regulation is an unwarranted extension of the plain meaning of the statute and cannot, therefore, be sustained. We hold that the petitioners are right.

We submit that the argument of the petitioners in *Maass* is equally applicable in the case at bar in respect to Treasury Regulation 20.2032-1(c)(2).

CONCLUSION

For the reasons set forth above, the decision of the District Court should be reversed.

Respectfully submitted,

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CERTIFICATE

It is hereby certified that counsel for appellants have examined the provisions of Rules 18 and 19 of this Court and are of the opinion that this brief conforms to all requirements.

JOYLE C. DAHL

January, 1966

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

SEC. 2032. ALTERNATE VALUATION.

(a) General.—The value of the gross estate may be determined if the executor so elects, by valuing all of the property included in the gross estate as follows:

(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

(26 U.S.C. 1958 ed., Sec. 2032)

Treasury Regulations on Estate Tax (1954 Code):

Sec. 20.2032-1 Alternate valuation.

(a) *In general.* In general, section 2032 provides for the valuation of a decedent's gross estate at a date other than the date of the decedent's death. More specifically, if an executor elects the alternate valuation method under section 2032, the property included in the decedent's gross estate on the date of his death is valued as of whichever of the following dates is applicable:

(i) Any property distributed, sold, exchanged or otherwise disposed of within one year after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of:

* * *

(c) *Meaning of "distributed, sold, exchanged, or otherwise disposed of."* (1) The phrase "distributed, sold, exchanged, or otherwise disposed of" comprehends all possible ways by which property ceases to form a part of the gross estate. For example, money on hand at the date of the decedent's death which is thereafter invested, falls within the term "otherwise disposed of." The term also includes the surrender of a stock certificate for corporate assets in complete or partial liquidation of a corporation pursuant to section 331. . . .

(2) Property may be "distributed" either by the executor, or by a trustee of property included in the gross estate under sections 2035 through 2038, or section 2041. Property is considered as "distributed" upon the first to occur of the following:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;

(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or

(iii) The actual paying over or delivery of the property to the distributee.

(26 C.F.R. Sec. 20.2032-1)

No. 20554

United States
Court of Appeals
for the Ninth Circuit

JOEL C. HERTSCHE, JR., EXECUTOR OF THE ESTATE OF JOEL C. HERTSCHE, DECEASED, AND JOEL C. HERTSCHE, JR., TRANSFEREE OF THE ASSETS OF THE ESTATE OF JOEL C. HERTSCHE, DECEASED

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee

On Appeal From the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLEE

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GANN PUBLISHING CO., PORTLAND, OREGON 2-25-66-50

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JOEL C. HERTSCHE, JR., EXECUTOR OF THE ESTATE OF JOEL C. HERTSCHE, DECEASED, AND JOEL C. HERTSCHE, JR., TRANSFEREE OF THE ASSETS OF THE ESTATE OF JOEL C. HERTSCHE, DECEASED

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee

On Appeal From the Judgment of the United States District Court for the District of Oregon

BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion of the District Court (R. 36-40) is reported at 244 F. Supp. 347.

JURISDICTION

This appeal involves federal estate taxes. The date of death was March 25, 1960. The taxes in dispute were paid as follows; $268,261.39 on June 26, 1961, and $8,810.80 on October 10, 1963. (R. 2-3). Claim

for refund in the amount of $9,012.93 was filed on January 15, 1964, and was rejected on June 16, 1964. (R. 4.). Within the time provided by Section 6532 of the Internal Revenue Code of 1954, on July 2, 1964, the taxpayer brought this action in the District Court for recovery of the taxes paid. (R. 54.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. The judgment of the District Court was entered on July 26, 1965. (R. 46.) Within sixty days thereafter, on September 23, 1965, a notice of appeal was filed. (R. 47.) Jurisdiction is conferred on this Court by 28 U.S., Section 1291.

QUESTIONS PRESENTED

Whether the District Court correctly held that the proper date for determining the value of certain stock for inclusion in decedents' gross estate was the date of the court order directing distribution of the stock.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1954:

SEC. 2032. ALTERNATE VALUATION.

(a) *General.*—The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:

(1) In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

* * * *

(26 U.S.C. 1958 ed., Sec. 2032.)

Treasury Regulations on Estate Tax (1954 Code):

§ 20.2032-1 *Alternate valuation.*

(a) *In general.* In general, section 2032 provides for the valuation of a decedent's gross estate at a date other than the date of the decedent's death. More specifically, if an executor elects the alternate valuation method under section 2032, the property included in the decedent's gross estate on the date of his death is valued as of whichever of the following dates is applicable:

(1) Any property distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of;

* * * *

(c) *Meaning of "distributed, sold, exchanged, or otherwise disposed of".* (1) The phrase "distributed sold, exchanged, or otherwise disposed of" comprehends all possible ways by which property ceases to form a part of the gross estate. For example, money on hand at the date of the decedent's death which is thereafter used in the payment of funeral expenses, or which is thereafter invested, falls within the term "otherwise disposed of." The term also includes the surrender of a stock certificate for corporate assets in complete or partial liquidation of a

corporation pursuant to section 331. The term does not, however, extend to transactions which are mere changes in form. Thus, it does not include a transfer of assets to a corporation in exchange for its stock in a transaction with respect to which no gain or loss would be recognizable for income tax purposes under section 351. Nor does it include an exchange of stock or securities in a corporation for stock or securities in the same corporation or another corporation in a transaction, such as a merger, recapitalization, reorganization or other transaction described in section 368 (a) or 355, with respect to which no gain or loss is recognizable for income tax purposes under section 354 or 355.

(2) Property may be "distributed" either by the executor, or by a trustee of property included in the gross estate under sections 2035 through 2038, or section 2041. Property is considered as "distributed" upon the first to occur of the following:

(i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;

(ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or

(iii) The actual paying over or delivery of the property to the distributee.

* * * *

(26 C.F.R., Sec. 20.2032-1.)

STATEMENT

The material facts, which were stipulated by the parties and are set forth in the pretrial order entered by the District Court (R. 1-6.) are as follows:

Joel C. Hertsche died testate in Oregon on March 25, 1960. At the time of his death decedent was the owner of 7,400 shares of National Lead Company common stock. (R. 2.)

On October 14, 1960, the Oregon probate court entered an order authorizing and directing the executor to distribute, among other bequests, 5,000 shares of National Lead Company stock to the persons entitled to receive them. (R. 2-3, 29.) On October 25, 1960, the executor distributed the 5,000 shares of National Lead stock to the residuary legatees by transfer and physical delivery. (R. 3.)

The stock was valued for estate tax purposes in the estate tax return at $79.6875 per share, which was the mean of the high and low selling prices on October 25, 1960. However, upon audit a deficiency in the amount of $25,312.50 was determined by the Commissioner, based on a valuation of the National Lead Company stock as of October 14, 1960, the date of the order of distribution. (R-3.)

The District Court found that the correct date for valuation of the stock was October 14, 1960, the date of the court order of distribution, as contended by the Government. (R. 36-40.)

SUMMARY OF ARGUMENT

Section 2032 of the Internal Revenue Code of 1954 provides in part that an executor may elect to value the assets of a decedent's estate for estate tax purposes as of "the date of distribution, sale, exchange, or other disposition" if such event occurs prior to the first anniversary of the decedent's death. The Treasury Regulations interpret distribution as meaning a court order or decree of distribution if such order precedes the actual delivery of the property to the beneficiary.

In this case there was a court order authorizing and directing partial distribution of an estate, including 5,000 shares of a certain common stock. However, the executor did not actually deliver the stock to the beneficiaries until eleven days after the court order. The executor, contending that the above-mentioned regulation is invalid, valued the stock as of the date of the actual delivery, but the District Court correctly upheld the validity of the regulation and found that the value should be as of the date of the order of distribution.

The meaning of the word "distribution" as used in Section 2032 must be determined by an analysis of its use in regard to decedents' estates and the purpose of Section 2032, rather than as an isolated word or its connotation in income tax situations. It is the general rule that an executor does not actually turn over estate property to beneficiaries without a court order or decree of distribution. Furthermore, it is this court order which, in most instances, vests title in, or establishes the rights of, the beneficiaries entitled to receive the property. Therefore, distribution as used in Section 2032 could mean the order of distribution or the actual delivery. In order to clarify this and create uniformity in the application of the provision, the regulation was enacted.

It is well settled that a long standing regulation may not be declared invalid except for weighty reasons, since it has the force and effect of law. This is particularly true when there has been continuous reenactment of the Code section and also when the regulation is a contemporaneous construction of the Code.

Furthermore, the regulation in question is a reasonable interpretation of the word distribution as used in Section 2032 and is in complete harmony with that

provision of the Code. The regulation is concerned with fixing a definite date for purposes of valuation which may be uniformly applied. In such a situation it is not necessary for the valuation date to coincide with the date the beneficiary reduces the property to possession. The regulation does not always benefit either the Government or the taxpayer, and is meant merely to avoid the uncertainty and confusion which would result from the various interpretations of the word distribution.

ARGUMENT

THE DISTRICT COURT CORRECTLY HELD THAT THE PROPER DATE FOR DETERMINING THE VALUE OF CERTAIN STOCK FOR INCLUSION IN DECEDENT'S GROSS ESTATE WAS THE DATE OF THE COURT ORDER DIRECTING DISTRIBUTION OF THE STOCK.

Prior to 1935 the property of a decedent was valued as of the date of death for the purpose of computing the estate tax. But in 1935 the law was changed to allow alternative valuations to be made one year from the date of death or, as Section 2032, *supra,* now states:

> In the case of property distributed, sold, exchanged, or otherwise disposed of, within 1 year after the decedent's death such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

Shortly after this new provision was enacted in 1935, Treasury Regulations interpreting this section were issued. Treasury Regulations 80, Art. 13 1 2 (T.D. 4699. XV-2 Cum. Bull. 293 (1936)). That regulation was the predecessor of Treasury Regulations on Estate Tax, Section 20.2032-1(c) (2), *supra,* which provides that —

> Property is considered as "distributed" upon the first to occur of the following:
>
> (i) The entry of an order or decree of distribution, if the order or decree subsequently becomes final;
>
> (ii) The segregation or separation of the property from the estate or trust so that it becomes unqualifiedly subject to the demand or disposition of the distributee; or
>
> (iii) The actual paying over or delivery of the property to the distributee.

In this case Joel Hertsche died on March 25, 1960, and, at that time he owned 7,400 shares of National Lead Company stock. On October 14, 1960, or within one year of the date of death, the Oregon probate court "authorized and directed" (R. 29) a partial distribution of the estate which included 5,000 shares of National Lead stock. On October 25, 1960, the executor actually delivered the 5,000 shares of stock to the heirs entitled to it. The executor valued the stock as of October 25, the date of the actual delivery, but the

Commissioner in accordance with the above regulation, determined that the stock should be valued as of October 14, the date of the order of distribution. The District Court correctly found that the regulation in question was valid and that it was therefore proper to value the stock as of the date of the order of distribution.

Taxpayer argues on this appeal that distribution as used in Section 2032 of the Internal Revenue Code means *only* "actual delivery" and therefore the regulation which states that distribution can occur at any other time is invalid. But, there is no merit to this contention. The meaning of the word distribution as used in Section 2032 is not clear, and the interpretative regulation, on which the Commissioner relied, which has been in effect for almost thirty years, is valid. Therefore the proper date for the valuation of the stock was October 14, 1960.

In *Towne* v. *Eisner,* 245 U.S. 418 (1918), Mr. Justice Holmes said (p. 425):

> A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.

With this in mind, we examine the word distribution as used in Section 2032 in order to determine its meaning. Section 2032 deals with the valuation of property for the purpose of computing the gross taxable estate. The dates relate either to the date of death of the decedent, or to the time prior to one year after death at which the property is separated from the estate. All of the acts enumerated in Section 2032(a)(1) apparently deal with the time at which the property is taken out of the general estate, such as by distribution, sale, exchange or other disposition. Therefore, distribution must be taken in this context and not, as taxpayer urges, in the context of various income tax sections of the Code.

There is no question that in almost all instances, actual physical delivery of estate assets is preceded by a court order or decree of distribution. In fact, Oregon follows the general rule that an executor or administrator who turns over estate property to anyone without a court order does so at his own risk, even if the persons are entitled to the property. See, *In re Freitag's Estate,* 165 Ore. 427, 434, 107 P. 2d 978, 980 (1940); *Weider* v. *Osborn,* 20 Ore. 307, 313, 25 Pac. 715 (1891); *In re Greer's Will,* 208 N.Y.S. 2d 243 (1960); *Barrett* v. *Macdonald,* 264 Minn. 560, 121 N.W. 2d 165 (1963); *Quevedo* v. *Union Pac. R. Co.,*

115 F. Supp. 25, 28 (N.D. Ill., 1953); *Adamo Estate,* 82 Pa. D. & C. 222 (1952). Therefore, it is clear that a court order will, in all but the unusual case, precede any physical distribution of property. Furthermore, it is also generally held that the order of distribution establishes the rights of the persons who are to receive the property, or vests title in them, and therefore separates the property from the estate. See, *Lang* v. *Lang,* 17 Utah 2d 10, 403 P. 2d 655 (1965); *Smith* v. *McLaren,* 58 Wash. 2d 907, 365 P. 2d 331 (1961); *Estate of Doescher,* 31 Cal. Rptr. 346, 217 Cal. App. 2d 104 (1963); *Oberlander* v. *Eddington,* 391 P. 2d 889 (Okla., 1964). In Oregon, as in many other jurisdictions, it is clear that the interest of a creditor, heir or devisee of an estate is subject to garnishment in the hands of the executor after an order for distribution.[1] *Thorsen* v. *Hopper,* 50 Ore. 497, 93 Pac. 361 (1908); *Harrington* v. *La Rocque,* 13 Ore. 344, 10 Pac. 498 (1886). See also Annotation, 59 A.L.R. 777.

As a result, it can be seen that the word "distribution" as used in the context of Section 2032, could have various meanings. In most instances it would mean the order or decree of distribution, since that is

---

[1]Although this is now taken care of by statute, Oregon Revised Statutes (Chapters Replaced 1963-1964), Section 29.175, the cases indicate that this was the law prior to the statutory provision.

the time at which the person entitled to the property receives his rights to the property or gets his title, or in effect, the property is separated from the estate, so that the actual physical transfer of the property has no significance. In these cases to have the value of the property for estate tax purposes depend on when the actual delivery of the property took place would be completely inconsistent with the language and purpose of Section 2032. The need for an interpretative regulation which clarifies the meaning of distribution as used in Section 2032 and provides for uniform application in this situation is manifest.[2]

Once it is determined that the word distributed is, in the context of Section 2032, ambiguous enough to allow interpretation, the only remaining question is the validity of Treasury Regulations on Estate Tax, Section 20.2032-1(c)(2)(i), which states that distribution may take place upon "The entry of an order or decree of distribution, if the order or decree subsequently becomes final." If this regulation is valid then the District Court was correct in holding that the stock

[2]It might also be noted that even in the income tax sections of the Code distribution does not always mean actual delivery. For instance, a dividend may be "distributed" from a corporation to a shareholder even though there was no actual transfer of funds from the corporation. See, *Clark* v. *Commissioner*, 266 F. 2d 698 (C.A. 9th, 1959).

must be valued as of October 14, 1960, the date of the order of distribution.

It is well settled that the Commissioner has the authority to issue Regulations interpreting the Internal Revenue Code, and that these Regulations will not be overruled by the courts except for weighty reasons. See e.g., *Commissioner* v. *South Texas Co.,* 333 U.S. 496 (1948). There are several theories upon which the validity and effect of a regulation is based. One is the theory of legislative re-enactment, most recently restated by the Supreme Court in *Commissioner* v. *Noel Estate,* 380 U.S. 678 (1965), which said (p. 682): "We have held in many cases that such a long-standing administrative interpretation, applying to a substantially reenacted statute, is deemed to have received congressional approval and has the effect of law." See also *Helvering* v. *Reynolds Co.,* 306 U.S. 110 (1939); *Cammarano* v. *United States,* 358 U.S. 498 (1959); *Helvering* v. *Winmill,* 305 U.S. 79 (1938). This rationale, i.e., that Congress is aware of the Treasury Regulations and gives its approval by reenacting the statute without changes, could be applied here since the regulation in question was originally issued in 1936[3], and the Code section has been

[3]Treasury Regulations 80, Article 13 1/2.

reenacted several times without substantial change, despite the major revisions of other sections of the Code. Another theory which could be applied is that of contemporaneous construction, since the original regulation was issued shortly after the Code section was added. Here the reasoning is that Regulations issued contemporaneously with the enactment of a statute will be presumed to represent the general understanding of the meaning of the statutes and of legislative intent. *Commissioner* v. *South Texas Co.*, 333 U.S. 496 (1947); *Fawcus Machine Co.* v. *United States*, 282 U.S. 375 (1931).

Furthermore, it can be demonstrated that the definition of distribution in the Regulations is in complete harmony with the statute rather than an "unwarranted extension of the statute" as contended by taxpayer. (Br. 7.) An examination of the history of Section 2032 reveals that Congress wanted to amend the old rule that property must always be valued at the date of the decedent's death for estate tax purposes.[4] While the purpose of this was to lessen the burden of the estate tax during a period when the value of property was declining, there is no indication that Con-

[4]See, H. Rep. No. 1681, 74th Cong., 1st Sess. (1939-1 Cum. Bull (Part 2) 642); H. Conference Rep. No. 1885, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 660); S. Rep. No. 1240, 74th Cong., 1st Sess .(1939-1 Cum. Bull. (Part 2) 651).

gress thought it was eliminating all inequities in every situation where there was a decline in the value of the assets of the estate. For instance, the latest possible date for the alternate valuation is one year from the date of death, but it is entirely possible that some estates which cannot be distributed within one year will continue to decline in value after the one year. In such a situation the beneficiaries would get no further relief, and would therefore receive no tax benefit from the shrinkage in the estate after the first year. Furthermore, two of the alternative dates, the date of death and one year after the date of death, are fixed with definite certainty, and if distribution were not defined there would be doubt and uncertainty as to exactly what date is meant by that word. Also, if distribution means only physical delivery, as taxpayer contends, then an executor would have great difficulty in controlling the estate. For instance, suppose a beneficiary refuses to accept delivery of property after the order of distribution, or for some other reason actual delivery of the property is not made. In such a situation the estate tax could not be determined, and, furthermore, by holding off on accepting his legacy one beneficiary could increase the estate tax and cause the others to bear the burden. It does not appear that a regulation which eliminates all these undesir-

able possibilities and fixes definite dates for the valuation of the property when it is taken out of the estate within one year of the decedent's death is out of harmony with the statute.[5]

It might be noted that the regulation in question is not one which will always benefit the Government, since the property may go up in value between the order of distribution and the actual delivery[6]. In fact, if that had been the situation in the instant case we wonder if taxpayer would be here contending that the regulation is clearly invalid. Obviously the purpose of the regulation is to fix with a degree of certainty the date of valuation, and to do so in the context of the purpose of Section 2032. The dates on which distri-

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[5]Taxpayer cites (Br. 10-11) the example given in H. Conference Rep. No. 1885, 74th Cong., 1st Sess. (1939-1 Cum. Bull. (Part 2) 660) as indicating that Congress intended "distribution" to mean actual delivery. But, in the example used in the committee report there is no mention of a court order or decree of distribution, which, as we have pointed out above, generally precedes any physical delivery. Therefore, this example shows either that Congress did not think about the particular problem of a court order when writing this example, or that the example refers to the unusual situation in which there is a physical delivery prior to or without a court order, in which case we agree that the value should be at the date of the physical delivery. See Section 20.2032-1 (c) (2) (iii).

[6]Furthermore, even when the value of the property does decline slightly before there is actual delivery, as in the instant case, this may not necessarily be detrimental to the legatee. Although a higher estate tax may be paid, the basis of the property in the hands of the legatee will also be higher (Section 1014, Internal Revenue Code of 1954), and this will be advantageous when he disposes of the property.

bution is effected according to the regulation are those on which the property is separated from the estate. In the instant case the court order directed distribution of the stock to certain devisees, which was within the authority of the court.[7] Although taxpayer asserts that the property was still in the estate and subject to its debts even after the court order, no authority for this is given and no case on point could be found. However, in view of the fact that, as pointed out above, the interest of a creditor or heir may be subject to garnishment after the court order of distribution, it is doubtful that the interest would be available for general creditors or that any dividends subsequent to the court order would go to the estate.

In any event, Section 2032 does not deal with the incidence of taxation but merely with the time at which valuation is to take place. In such a situation receipt or control of the property is not the important factor. See *Chase Nat. Bank* v. *United States,* 278 U.S. 327 (1929). Therefore, the fact that the regulation requires that the value is determined on a date

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[7]Although the order for partial distribution was requested from the court under Oregon Revised Statutes (Chapters Replaced 1961-1962), Sec. 117.350, which authorizes such distribution, the court order itself "authorized and directed" (R. 29) the distribution, and, under Oregon Revised Statutes (Chapters Replaced 1963-1964), Sec. 5.040, the court does have the authority to "direct" the payment of debts and legacies.

prior to the one on which the beneficiary receives actual possession does not mean that the regulation is invalid.

It is also important to note that this is apparently the first time in almost 30 years that anyone has challenged the validity of the particular regulation involved. If, as taxpayer contends, it is so clear that distribution means physical distribution, and the regulation is clearly unwarranted, then why has no one brought this to the attention of the courts before this? We submit that it is because it is quite logical to define the word "distribution" as used in Section 2032 and furthermore the regulation in question gives the word a reasonable definition. The mere fact that the regulation happened to work a slight disadvantage to taxpayer in this situation is certainly not a "weighty reason" for declaring the regulation invalid.

CONCLUSION

For the foregoing reasons, the decision of the District Court is correct and the judgment should be affirmed.

Respectfully submitted,

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MARCH, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ~~23rd~~ 2nd day of ~~February~~ March, 1966.

SIDNEY I. LEZAK,
United States Attorney

No. 20554

United States
COURT OF APPEALS
for the Ninth Circuit

JOEL C. HERTSCHE, JR., Executor of the Estate of Joel C. Hertsche, Deceased, and JOEL C. HERTSCHE, JR., Transferee of the assets of the Estate of Joel C. Hertsche, Deceased,

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee.

REPLY BRIEF FOR THE APPELLANTS

On Appeal From the Judgment of the United States District Court for the District of Oregon

WALDEN STOUT,
DONALD J. GEORGESON,
JOYLE C. DAHL,
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No. 20554

United States
COURT OF APPEALS
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JOEL C. HERTSCHE, JR., Executor of the Estate of Joel C. Hertsche, Deceased, and JOEL C. HERTSCHE, JR., Transferee of the assets of the Estate of Joel C. Hertsche, Deceased,

Appellants,

v.

UNITED STATES OF AMERICA,

Appellee.

REPLY BRIEF FOR THE APPELLANTS

On Appeal From the Judgment of the United States District Court for the District of Oregon

ARGUMENT

I

Introduction

Section 2032 of the Internal Revenue Code of 1954 sets forth in clear and concise terms various rules regarding the elective alternate valuation of a decedent's gross estate. This statutory provision plainly states that prop-

erty distributed by an estate within one year of the decedent's death is to be valued as of the date of distribution. Both parties are in agreement that the stock in question was distributed on October 25, 1960 (R. 3; Gvt. Br. 5). It was correctly valued on that date for estate tax purposes by the Appellant-executor in accordance with the governing statute.

Although neither the Appellant-executor nor the government had any apparent difficulty in determining the distribution date, the government asserts that the statute should be ignored because its use of the term "distributed" is ambiguous (Gvt. Br. 10-13). For this reason, it contends that its own regulation, Treasury Regulation 20.2032-1(c)(2), should be followed rather than the statute. Pursuant to its regulation, the government then concludes that the proper date for valuation is not the date of distributon, but the date distribution was authorized by the probate court.

As outlined in our opening brief, our answer to the government's argument is two-fold. First, the statute is not ambiguous and needs no interpretation by regulation. The term "distribution" is used many times throughout the Internal Revenue Code without difficulty and without need for elaborate definition. Second, even conceding the government's view that the statute is ambiguous, the regulation relied upon by the government exceeds the authority granted to the Treasury to promulgate needful interpretative regulations.

II

The Term "Distribution" As Used in Section 2032 of the Internal Revenue Code of 1954 is not Ambiguous.

As we have noted, the term "distribution" is used in numerous places and in various contexts throughout the tax law. It is always given its commonly understood meaning. This is not disputed by the government. Instead, the government contends that the word is ambiguous only as it is used in Section 2032 (Gvt. Br. 10). To support its contention, the government raises several points of state law dealing with the administration of estates in an attempt to demonstrate the importance of the order of distribution (Gvt. Br. 11-13).

Not only is the government incorrect in most of its statements regarding state law, as we shall see, but, more importantly, such references are simply irrelevant. While we do not deny the importance of orders authorizing distribution as a matter of probate law, this fact adds nothing to the question of whether or not the word "distribution", as used in the statute, is ambiguous. By its argument, the government is apparently attempting to establish the proposition that the entry of the order authorizing distribution is tantamount to actual distribution, or *is* distribution itself, at least within the intent of Congress when it enacted Section 2032. From this reasoning, the conclusion is reached that since one of several possible events can be construed as actual distribution, the word is ambiguous.

The government's major premise is false. Quite clearly, the authorization to distribute is not distribution it-

self, just as an order authorizing the sale of property from an estate is not an actual sale.[1] As to whether Congress intended that the order authorizing distribution be deemed actual distribution within the meaning of the statute, the government provides its own answer in footnote 5 on page 17 of its brief.

In its discussion of state law, the government asserts that the order of distribution establishes the rights of the persons who are to receive the property or vests title in them, and further asserts that a beneficiary's interest in an estate is subject to garnishment after the entry of an order of distribution (Gvt. Br. 12). While we do not believe these points are material to the issues in this case, we feel compelled to disclose their inaccuracy.

In respect to the passage of title, it has long been the law in Oregon that fee title to ownership of the real property of a decedent passes immediately upon his death to his heirs or devisees, subject only to the payment of the debts of the deceased and the right of the personal representative to possession for the purposes of administration. *D'Arcy* v. *Snell,* 162 Or. 351, 364 (1939); *Blake* v. *Blake,* 147 Or. 43, 49 (1934). Title to the personal property of a decedent vests upon death in the executor or personal representative of his estate, in trust, however, with full equitable title vesting immediately in the heirs or distributees. In *Re McLeod's Estate,* 159 Or. 687, 696 (1938).

---

[1] Treasury Regulation 20.2032-1(c)(2) recognizes this difference in respect to sales.

As to garnishment, it is clear that under Ore. Rev. Stat. 29.175, the interest of any person in personal property belonging to the estate of a decedent may be subject to garnishment at any time during the administration of an estate and not merely after the entry of an order of distribution. That is the very purpose of the statute. Under prior law, garnishment could be made only after the entry of an order of distribution. *Harrington* v. *LeRocque*, 13 Or. 344 (1886). The above statute was passed in 1931 to correct this situation and overrule cases such as *Harrington*.[2] Thus, the date distribution is ordered has not been material on the question of garnishment for many years. Jaureguy and Love, Oregon Probate Law and Practice, § 831 (1958).

Based solely upon its erroneous analysis of state probate law, the government concludes that the term "distributed", as used in Section 2032, is ambiguous. It then states (Gvt. Br. 13) that the "need for an interpretative regulation . . . is manifest." We submit that the government has failed to show any reason, let alone a good reason, why we should not be entitled to rely upon the alternate valuation statute as written in determining the estate tax value of the disputed stock.

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[2] The government erroneously states (Gvt. Br. 12) that *Harrington* v. *LaRocque, supra,* is still the law, having been codified by Ore. Rev. Stat. 29.175.

III

Treasury Regulation 20.2032-1(c)(2) Improperly Extends the Statute and Should Be Disregarded.

Predictably, the government's case is built on the following steps: the statute, being ambiguous, needs a regulation to interpret it; the regulation in question serves this function and was issued under authority granted to the Treasury Department; it should not be set aside except for weighty reasons.

As we have shown, the statute is not ambiguous and can be easily applied without the aid of the regulation. Moreover, the regulation in dispute purports to do far more than merely interpret the word "distribution." Rather than simply define what is meant by distribution, it provides that three possible events, only one of which is really distribution, shall be *considered* synonymous with distribution. Thus, the regulation does not merely interpret the statute, it establishes its own rules.

On pages 14-15 of the government's brief, numerous authorities are cited which contain certain well-worn theories concerning the legal aspect of regulations issued by the Treasury Department. They were discussed in our opening brief (Br. 20-22), and require no further comment here.

On pages 15-17 of its brief, the government contends that its regulation is in harmony with the statute it purports to interpret. One of the reasons given by the government to support this assertion is that without the regulation doubt and uncertainty would exist as to when distribution occurred. This is without merit, as dis-

closed by the regulation itself. When the statute was enacted employing the word "distribution" alone, certainly no one could deny that this meant actual distribution. The regulation, however, adopts any one of three possible events as within the meaning of the word "distribution". We submit that the regulation itself builds in the doubt and uncertainty complained of by the government.

Moreover, it should be pointed out that one of the three events the regulation considers as distribution, in order to clear up the supposed doubt and uncertainty, is actual distribution. As noted, this is the event that is supposedly doubtful and uncertain according to the government. Thus, the government by its regulation is attempting, in part, to define a word with the same word.

The government further states (Gvt. Br. 16) that if distribution means physical delivery only, then an executrix would be unable to control the estate in the event delivery cannot be made, such as through the unwillingness of a beneficiary to accept his inheritance. This argument is meaningless, because an estate can always be distributed. Ore. Rev. Stat. 117.310(2) provides a remedy in the event a beneficiary refuses to apply for his distributive share of an estate by directing it to be paid to the County Treasurer and, eventually, to the Oregon State Land Board.

On page 17 of its brief, the government argues that the regulation in question is not one that will always benefit the government because property may go up in value between the order of distribution and the actual

delivery. This is true. However, this did not occur with respect to the Appellants in this case, and therefore, is of no consolation to them. They simply believe that they are entitled to have their case determined according to the statute.

On pages 18-19 of its brief, the government points out that Section 2032 does not deal with the incidence of taxation but merely with the time at which valuation is to take place. For this reason, it states that actual receipt or control of the property is not the important factor. We would agree, except for the fact that the statute specifically designates that valuation is to be made on the date of distribution and on no other date.

The government concludes its brief by adding (Gvt. Br. 19) that no one has challenged the validity of the particular regulation involved for some thirty years. What this has to do with the legal rights of the taxpayers in the case at bar is not explained. The fact that no one has challenged the regulation, at least in a reported court decision, does not make it right. We should further point out that the lack of controversy over this regulation may be attributable to more than merely blind acceptance by taxpayers. It could well be that the issue has been undetected by the government's examiners in numerous estates since the regulation was adopted.

Finally, the government attempts to brush off our case (Gvt. Br. 19) on the ground that the regulation worked only a "slight disadvantage" to the Appellants. While the amount in controversy may be small, from the government's point of view, it is not a small item to the Appellants.

CONCLUSION

The decision of the District Court should be reversed.

Respectfully submitted,

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Attorneys for Appellants

CERTIFICATE

It is hereby certified that counsel for Appellants have examined the provisions of Rules 18 and 19 of this Court and are of the opinion that this brief conforms to all requirements.

JOYLE C. DAHL

April, 1966

No. 20567

United States
COURT OF APPEALS
for the Ninth Circuit

ALONZO W. DERING,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of Eldon P. Dering, bankrupt,

Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

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The District Court erred in finding:

"4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt."

on the grounds and for the reasons:

a. The evidence was insufficient to establish the purported fact;

b. such finding was inconsistent with the theory upon which the appellee tried the case.

Argument II 19

The district court erred when it:

Refused to give force or effect to the option of September 30, 1951, and appellant's exercise thereof

for the following reasons:

If the options executed in 1961-64 were security devices, then the original option of September 30, 1951 was in full force and effect; any rights of the bankrupt or appellee in or to the stock were subject to appellant's right to purchase such stock, upon the bankruptcy or insolvency of bankrupt, at its book value with credit given appellant for the funds already paid bankrupt; appellant exercised that option right.

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The district court erred in finding that:

"6. Within one year prior to the adjudication of bankruptcy on April 16, 1964, at a time when the bankrupt was insolvent, the bankrupt transferred to the defendant his equitable interest in the stock of the corporation. The only consideration for the transfer was the cancellation of the bankrupt's indebtedness and accrued interest."

"8. The transfer and surrender of the bankrupt's equitable interest in the 100 shares of corporation stock, which had a fair market value of $25,120.00 in consideration of the cancellation of the bankrupt's indebtedness and accrued interest thereon, aggregating $10,600-.00 was without fair consideration."

on the following grounds:

a. There was no evidence to support such findings;

b. Such findings are inconsistent with the finding that the transactions between the parties were security devices.

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ALONZO W. DERING,

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Appellee.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

JURISDICTIONAL STATEMENT

This action was commenced in the United States District Court for the District of Oregon by appellee-trustee in bankruptcy for Eldon P. Dering, a bankrupt, to recover moneys claimed to be due appellee from appellant-defendant, by reason of transactions between appellant and bankrupt involving certain shares of capital stock of Dering Industries, Inc., an Oregon corporation, orig-

inally owned by bankrupt (R. 1-6). The appellee based his alleged cause of action upon Sec. 67 (d) (2) of the Bankruptcy Act (11 U.S.C. 107 (d) (2). Jurisdiction existed by reason of Section 67(e) of the Bankruptcy Act (11 U.S.C.A. 107 (e).)

This appeal is from a judgment entered, after trial, in favor of appellee (R. 90) based upon Findings of Fact and Conclusions of Law (R. 87-90) which were entered over objections of appellant (R. 59-67, 83-86).

The designated record in this Court includes the entire record in the district court, including Notice of Appeal, Undertaking and other documents necessary to perfect this appeal (R. 96-7).

STATEMENT OF FACTS

Dering Industries, Inc., an Oregon corporation, was organized in 1951 with 200 shares of capital stock. Eldon P. Dering, the bankrupt herein, and Alonzo T. Dering, appellant-defendant were the only original stockholders, each owning 100 shares. The bankrupt and appellant were officers and directors of the corporation during the entire period involved.

At the time of the organization of the corporation, (September 30, 1951) Eldon P. Dering, the bankrupt, for a good and valuable consideration, executed and delivered to appellant, Alonzo T. Dering, an option giving appellant the right to purchase any stock in Dering Industries, Inc., which the bankrupt might own "at a price per share based on the cost price of the inventory

and book assets of the corporation as shown by its records less current indebtedness" in the event the bankrupt became "bankrupt or insolvent." The Pre-Trial Order includes an admission of the execution of this option as well as the consideration therefor (R. 28 L. 14 to R. 30 L. 10).

Dering Industries, Inc. acquired a franchise or license to manufacture metal gates. At the time of the hereinafter mentioned transactions, the licensor was Life-Time Gate Company, a subsidiary of Moncreif-Lenoir of Houston, Texas (Tr. 5-6). This franchise or license was transferable only with the consent of the licensor (Ex. 29, Tr. 64).

According to the admitted facts contained in the Pre-Trial Order, the corporation continued operation without any change in the stock ownership until on or about December 6, 1961, when appellant paid the bankrupt the sum of $10,000.00 in return for which the bankrupt endorsed and delivered to appellant the stock certificate covering the 100 shares of capital stock in Dering Industries, Inc., theretofore owned by him (R. 30 Pre-Trial Order Para. IV). Simultaneously appellant executed and delivered to the bankrupt an option to purchase stock wherein appellant granted the bankrupt the exclusive right to purchase 100 shares of the capital stock of Dering Industries, Inc., for a period of 180 days for $10,000.00, together with interest at the rate of 6% per annum from date until the exercise of such option (R. 30-31).

On or about the 6th day of June, 1962, the bankrupt

paid appellant the sum of $3,000.00 and the appellant executed and delivered to the bankrupt a similar option to purchase stock, except that it covered only 70 shares of the capital stock of Dering Industries, Inc. (R. 31-32).

On or about the 6th day of December, 1962, the bankrupt paid appellant the sum of $3,000.00. Appellant applied some of the money to interest under the terms of the option. Appellant executed and delivered to the bankrupt a similar option except that it covered only 48 shares of the capital stock of Dering Industries, Inc. (R. 32).

Thereafter, on or about the 20th day of February, 1963, appellant paid the bankrupt the sum of $5,850.00; the stock certificate originally issued to the bankrupt, covering 100 shares of Dering Industries, Inc., which had been endorsed and delivered to appellant on December 6, 1961, was cancelled and the corporation issued certificates representing these shares to appellant (R. 34). At the same time, appellant executed and delivered to the bankrupt an option covering the right to purchase 100 shares of such stock (R. 32-34).

Compensation of the bankrupt and appellant, for services rendered to Dering Industries, Inc. was fixed on an annual basis. For the year ending June 30, 1963, the bankrupt received $3,000 compensation; subsequent to that time, his compensation was $600.00 per year (Tr. 77); the minutes of a meeting of stockholders of the corporation, signed by the bankrupt as secretary, dated September 25, 1963 (Ex. 41) recite:

"all the stock of Dering Industries, Inc., is now owned by Alonzo W. Dering as Eldon P. Dering sold his shares during the year, Eldon P. Dering has an option to purchase the number of shares in Dering Industries, Inc., that were sold."

Appellant had knowledge of the insolvency of the bankrupt from and after November 1, 1963 (R. 37).

On March 3, 1964, appellant wrote a letter to W. F. Lenoir, Jr., of Life-Time Gate Co., indicating his desire to sell the capital stock of Dering Industries, Inc., and requesting an offer (Ex. 22).

On March 4, 1964, the last option was executed by the bankrupt and appellant (R. 34-35).

On March 10, 1964, appellant received a letter from Life-Time Gate Co., indicating that they were not interested in purchasing the corporate stock (Ex. 24).

Appellant commenced negotiations with Western Fence & Wire Works, Inc., an Oregon concern, and that company (Ex. 27) as well as the appellant wrote to Life-Time Gate Co. (Ex. 28). The testimony was conflicting as to the amount of the proposed purchase price, if a sale were to be made to Western Fence. Appellant testified that the price was to be $10,000.00 for the franchise or license, plus the value of the other assets (Tr. 29). Mr. Galton, a representative of Western Fence, testified that his recollection of the prices mentioned was different than the appellant's recollection (Tr. 90, 92, 96, 97).

Life-Time Gate Co. refused to consent to a transfer

of the franchise to Western Fence (Ex. 29). Life-Time Gate Co. did not know the price discussed in the negotiations of appellant with Western Fence (Tr. 30), and offered orally to pay $25,000.00 for the franchise, plus the value of the other assets. This oral offer was confirmed by letter under date of March 27, 1964 (Ex. 29). This agreement was wholly executory (Tr. 27). The amount agreed to be paid for the franchise was more than appellant had asked of Western Fence, but apparently was fixed by previous negotiations (Tr. 64, 65).

The bankrupt filed his petition in voluntary bankruptcy in the District Court of the United States of America for the District of Oregon on April 16, 1964 (Ex. 1), and was adjudicated as such.

The Statement of Affairs filed by the bankrupt with his petitions and schedules, in such bankruptcy (Ex. 1) included the following:

"11. Transfer of Property

a. What property have you transferred or disposed of, other than in the ordinary course of business, during the year immediately preceding the filing of the original petition herein?

Released option to purchase stock in Dering Industries, Inc., to brother Alonzo Dering on 3/4/64"

Appellant was not listed as a creditor in the schedules filed in the bankruptcy proceeding (Ex. 1).

On or about June 30, 1964, the executory contract between the appellant and Life-Time Gate Co. was performed, by the transfer of the 200 shares of capital stock

of Dering Industries, Inc. to the purchaser and payment to appellant of the sum of $50,240.00.

On June 30, 1964, a letter on behalf of appellant was addressed to the bankrupt, with copies to the Referee in Bankruptcy before whom the matter was pending, and the attorney for the trustee, stating that if the bankrupt or trustee claimed any interest in the capital stock of Dering Industries, Inc., appellant desired to exercise the option of September 30, 1951 (Ex. 36). The book value of 100 shares of the capital stock of Dering Industries, Inc., as of May 31, 1963, was $12,494.00 (Ex. 33). The book value of 100 shares as of June 30, 1964, was $12,620.74 (Ex. 34). The franchise was not carried upon the books as an asset (Ex. 33).

On or about December 1, 1964, the appellee commenced this action against appellant, seeking to recover one-half of the price received by the appellant for the sale of the capital stock of Dering Industries, Inc., less $10,600.00, relying upon Sections 67 (d) (2) and (e) of the Bankruptcy Act (11 U.S.C. 107 (d) (2) and (e):

> "Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this title by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or (b) as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is en-

gaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital, without regard to his actual intent; or (c) as to then existing and future creditors, if made or incurred without fair consideration by a debtor who intends to incur or believes that he will incur debts beyond his ability to pay as they mature; or (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors."

"(e) For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction."

The Pre-Trial Order, under admitted facts, including the following:

"The defendant (appellant) then (February 20, 1963) had all the legal and equitable interests in all the corporate stock (of Dering Industries, Inc.) subject only to the foregoing option (of February 20, 1963)" (R. 34).

The case was tried by the appellee on the theory that the agreement of March 4, 1964, which followed the option of February 20, 1963, was in fact an option and that the appellee had assumed it under the provisions of 11 U.S.C. Sec. 110 (6) (b);

"(b) The trustee shall assume or reject an executory contract * * * within sixty days after the

> adjudication * * * but the court may for cause shown extend or reduce the time. Any such contract * * * not assumed or rejected within that time shall be deemed to be rejected. * * *"

and that he was entitled to the benefits of the option contract (R. 38) Pre-Trial Order P. 12 L. 18-27) (Tr. 34, 36, 37, 43, 49, 104). That performance thereof by the trustee was excused because appellant had repudiated the agreement (Tr. 47). Appellee also sought to amend his contentions in the Pre-Trial Order to allow this to be shown (Tr. 106).

The case was defended on the theory that the appellee had not assumed this executory contract within 60 days after bankruptcy as required by this statute, and if any rights had existed, in favor of the trustee, they had been lost (Tr. 36, 37).

After trial before the Hon. W. T. Beeks, without a jury, the Court rendered its Memorandum Opinion, holding that the appellee had failed to prove that he had assumed the executory option agreement between appellant and bankrupt dated March 4, 1964, but allowing recovery by appellee of one-half the price received by appellant for the corporate stock, less $10,600.00 and an allowance for services rendered (R. 49-52).

The appellee prepared Findings of Fact, Conclusions of Law based upon such Memorandum Decision (R. 53-58) to which appellant filed objections (R. 59-67).

Then the Hon. W. T. Beeks, Judge of the District Court, prepared "Findings of Fact and Conclusions of

Law Proposed by the Court" (R. 79-82) to which appellant filed objections (R. 83-86).

After a hearing upon such objections, Findings of Fact, Conclusions of Law and Judgment were entered herein in accordance with the Findings etc., proposed by the trial Court (R. 87-90).

SPECIFICATIONS OF ERROR

1. The District Court erred in finding:

> "4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt (R. 88 Findings etc.).

on the grounds and for the reasons:

a. That the evidence was insufficient to establish the purported fact;

b. That such finding was inconsistent with the theory upon which the appellee tried the case.

2. The District Court erred in refusing to give force or effect to the option of September 30, 1951, and appellant's exercise thereof, for the following reasons:

a. If the "options" executed in 1961-64 were security devices, then the original option of September 30, 1951 was in full force and effect; any rights of the bankrupt or appellee in or to the stock were subject to appellant's

right to purchase such stock, upon the bankruptcy or insolvency of bankrupt, at its book value with credit given appellant for the funds already paid bankrupt; appellant exercised that option right.

3. The District Court erred in finding that:

> "6. Within one year prior to the adjudication of bankruptcy on April 16, 1964, at a time when the bankrupt was insolvent, the bankrupt transferred to the defendant his equitable interest in the stock of the corporation. The only consideration for the transfer was the cancellation of the bankrupt's indebtedness and accrued interest." (R. 88)

and

> "8. The transfer and surrender of the bankrupt's equitable interest in the 100 shares of corporation stock, which had a fair market value of $25,120.00 in consideration of the cancellation of the bankrupt's indebtedness and accrued interest thereon, aggregating $10,600.00 was without fair consideration." (R. 89)

on the following grounds:

a. There was no evidence to support such findings;

b. Such findings are inconsistent with the finding that the transactions between the parties were security devices.

SUMMARY OF ARGUMENT

The rights and liabilities of the parties growing out of subsequent transactions, are affected by the option given by the bankrupt to appellant, at the time Dering

Industries, Inc. was organized, by which bankrupt agreed to sell appellant any stock bankrupt owned, at book value, in the event bankrupt became "insolvent or bankrupt".

If subsequent transactions were treated as sales with options to repurchase, the original option had no effect because bankrupt owned no stock, at the time of bankruptcy, upon which the option could operate.

If subsequent transactions were treated as security devices, then, when bankrupt was adjudicated as such, appellant had the right to buy any interest bankrupt had in any such stock, at book value, with credit for money advanced. Appellant gave notice of the exercise of this option.

Appellee elected to treat the transactions as options. The District Court held appellee failed to prove that he had assumed the last executory option contract, and that appellee could not recover on that theory.

Although the evidence does not support the finding, the District Court found the options to be security devices but failed to give effect to the original option.

Although there were no contentions or evidence that any such transaction had occurred, the District Court also held that there had been a transaction within one year of bankruptcy, in which bankrupt had surrendered his equity in such stock, in cancellation of indebtedness.

Having held that such a voidable transaction had occurred, the District Court did not set it aside, which would have reinstated the previous option, but entered

judgment in favor of appellee, to the same effect as if appellee had proven he had assumed the last option contract.

ARGUMENT

I

The District Court erred in finding:

> **"4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt." (R 88 Findings etc.)**

on the grounds and for the reasons:

a. The evidence was insufficient to establish the purported fact;

b. Such finding was inconsistent with the theory upon which the appellee tried the case.

There is no conclusive test of universal application to determine whether or not a transaction is a security device. *Blue River Sawmills et al* v. *Gates* (1961) 225 Or. 439, 461, 358 P.2d 239.

Some of the factors to be considered in determining whether a transaction is a sale with an option back or a security device, are:

a. A disputable presumption exists that an unconditional transfer is what it purports to be, and evidences the intention of the parties. In the absence of "clear, convincing and consistent proof to the contrary" such presumption prevails.

b. The primary inquiry is the discovery, if possible, of the mutual intention of the parties at the time the transaction was consummated. Subsequent acts and admissions, while material and relevant, are evidence of the pre-existing intent.

c. Negotiations had between the parties prior to the consummation of the transaction are the most promising point of inquiry. Negotiations originating out of an application for a loan tend to support the conclusion that the transaction was intended as a mortgage; the converse is equally true, when the negotiations begin with an offer of sale, it tends to support the conclusions that the transaction is not a security device.

d. Business, social or other relationships of the parties are circumstances relevant to the main issue of intention.

e. The fact that the transfer and an option to repurchase were written and dated the same day is a circumstance to be considered, but standing alone, proof of an option to repurchase does not furnish conclusive, nor necessarily persuasive proof that the transaction was a loan and not a sale.

f. Ordinarily the test to determine whether a transfer coupled with an agreement by the transferee to reconvey the property is a mortgage is whether there is an unsatisfied indebtedness owing the grantee which is enforceable independent of the transfer. The absence of a personal debt "raises such a strong natural inference in this sort of case that the transaction was a sale that it practically establishes the point".

g. If there is an agreement to reconvey and the optionor cannot compel repayment, the agreement may be regarded as a conditional sale.

h. A need for funds, in and of itself, does not indicate unsatisfied and demanding creditors.

i. Inadequacy of the price received is to be considered.

j. Requirement that interest be paid is a factor to be considered.

Blue River Sawmills et al v. Gates (1961) 225 Or. 439, 358 P.2d 239.

Kohler v. Gilbert (1959) 216 Or. 483, 339 P.2d 1102.

Colahan v. Smyth (1938) 159 Or. 569, 81 P.2d 112.

Testing the evidence in the instant case against the above factors:

The only testimony of the intention of the parties at the time, was the evidence of appellant that the transaction was intended to be a sale, with an option to repurchase (Tr. 9, 20); the bankrupt was not called as a witness; there was no explanation of this failure except that he presumably was in Phoenix, Arizona (Tr. 5). A failure to call a witness, or take his deposition, when that witness must have been acquainted with the facts "is significant" *Blue River Sawmills et al* v. *Gates supra,* p. 547.

Subsequent acts or admissions of the parties include minutes of the corporation, dated September 23, 1963,

signed by the bankrupt in which it is recited that appellant owned all the stock in Dering Industries, Inc. (Ex. 41).

In his statement of affairs, filed with his petition in bankruptcy, the bankrupt stated:

> "11 Transfer of Property.
>
> 2. What property have you transferred or disposed of, other than in the ordinary course of business during the year immediately preceding the filing of the original petition herein? Released option to purchase stock in Dering Industries, Inc. to brother, Alonzo Dering on 3/4/64." (Ex. 1)

There was no evidence of previous negotiations. The bankrupt and the appellant are brothers.

There was no evidence of any debt owed appellant by bankrupt, payment of which appellant could have enforced. Appellant was not listed as a creditor of bankrupt in the schedules filed in bankruptcy (Ex. 1).

The appellant knew bankrupt wanted money, but did not know the reason (Tr. 15).

The price paid for the stock, $100.00 per share, was not inadequate. The book value of the physical assets did not exceed this valuation by any large percentage (Ex. 33, 34, 35, Tr. 26). The franchise or license was of uncertain or indefinite value. It was not carried on the books as an asset. It could not have been transferred without the licensor's consent. At the time the last option contract was signed (March 4, 1964) there was a distinct possibility that the franchise might be lost without any

compensation. Appellant testified that if he was unable to sell the stock, he was going to liquidate the business (Tr. 27, 73, 81). After the executory contract for sale of the capital stock to Life-Time Gate was made, there was a possibility that the purchaser might not perform its contract, leaving appellant with an action for damages for breach of contract.

The options required the payment of interest upon the price fixed therein, from date thereof to exercise of the option.

MEMORANDUM DECISION OF TRIAL COURT

In its Memorandum Decision, (Appendix A) the District Court held that the controlling factors were:

1. Interest.
2. The stock was never transferred to the defendant on the corporation's books.
3. The continuance of the bankrupt's share of the profits, unaltered by the "sale" of his stock to the defendant.

With all due respect to the District Court, the grounds for its decision, except as to interest, were contrary to the admitted facts of the case.

The Pre-Trial Order includes the following under Admitted Facts:

> "The certificate for 100 shares of stock originally issued to the bankrupt was surrendered and cancelled on the corporate books (on February 20,

> 1963) and a new certificate therefor was issued to the defendant." (R. 34 Pre-Trial Order P. 8, L. 11-14.)

and the undisputed evidence was that at the yearly corporate meeting after the February 20, 1963 transaction, the compensation of the bankrupt, to be received by him from Dering Industries, Inc. was reduced from $3,000.00 per year to $600.00 per year (Tr. 77). While the appellant called payments to bankrupt for previous years, a method of distributing profits from the corporation (Tr. 20, 21, 53), any such plan was ended when the corporate stock formerly owned by bankrupt was issued in the name of appellant, more than one year before bankruptcy (Tr. 22). This change did not result from any agreement between the defendant and appellant, but was unilateral action of appellant as the sole stockholder of the corporation (Tr. 22-23).

It is respectfully submitted that the preponderance of the evidence does not establish that the transactions were security devices; considering that the appellee had the burden of establishing the facts by "clear, convincing and consistent proof", it must be held that such proof is lacking. Appellant believes appellee recognized that fact before trial and therefore treated the transactions as options and endeavored to prove assumption thereof and performance or excuses for non-performance.

ARGUMENT

II

The District Court erred when it:

> **"Refused to give force or effect to the option of September 30, 1951, and appellant's exercise thereof"**

for the following reasons:

If the "Options" executed in 1961-64 were security devices, then the original option of September 30, 1951 was in full force and effect; any rights of the bankrupt or appellee in or to the stock were subject to appellant's right to purchase such stock, upon the bankruptcy or insolvency of bankrupt, at its book value with credit given appellant for the funds already paid bankrupt; appellant exercised that option right.

The situation confronting the appellee prior to commencement of this action, was.

1. If the transactions between the bankrupt and appellant during 1961-64 were to be considered as options, the original option of September 30, 1951 would no longer be in effect, since the bankrupt owned no stock upon which it could operate. If the appellee could establish that he had assumed the option contract of March 4, 1964, and that he had performed thereunder, or been excused from performance, appellee could recover under the option.

2. If the transactions between the bankrupt and appellant during 1961-64 were to be considered as security devices, with the bankrupt owning the equitable interest in 100 shares of Dering Industries, Inc. capital stock,

subject to a pledge in the amount of $10,600.00, such equitable interest of the bankrupt would be subject to the option of September 30, 1951, and appellant had the right to purchase such stock for its book value, and would be entitled to credit upon that purchase price for the amount of the claimed loan plus interest. The appellant had given notice of his intention to exercise the option of September 30, 1951.

Confronted with this situation, the trustee elected to treat the options as being what they purported to be, and endeavored to prove the trustee's acceptance and performance, or excuse for non-performance, of the terms of the last option—that of March 4, 1964. This he failed to do.

On its own initiative, the District Court found such transactions to be security devices. Appellant has assigned such finding as error, but, having made such finding, the District Court committed additional error by not giving effect to the option of September 30, 1951, which would have limited the recovery of the appellee herein to the difference between the book value of the stock and the claimed loan plus interest.

The execution and consideration for this original option of September 30, 1951 is admitted (R. 28-30, Par. III Pre-Trial Order) and its continued existence was not challenged except for a contention of appellee (in line with the theory that these transactions were options and not security devices) that:

> "3. The agreement of March 4, 1964, relative to the sale or liquidation of Dering Industries, Inc.

> must be construed as superseding any and all prior agreements, options, understandings and arrangements between the defendant and the bankrupt, the parties thereto." (R. 38)

which was not sustained.

By failing to give effect to this original option, the District Court increased the effect of its original error in holding the transactions to be security devices.

ARGUMENT

III

The District Court erred in finding that:

> **"6. Within one year prior to the adjudication of bankruptcy on April 16, 1964, at a time when the bankrupt was insolvent, the bankrupt transferred to the defendant his equitable interest in the stock of the corporation. The only consideration for the transfer was the cancellation of the bankrupt's indebtedness and accrued interest."**
>
> **"8. The transfer and surrender of the bankrupt's equitable interest in the 100 shares of corporation stock, which had a fair market value of $25,120.00 in consideration of the cancellation of the bankrupt's indebtedness and accrued interest thereon, aggregating $10,600.00 was without fair consideration."**

on the following grounds:

a. There was no evidence to support such findings;

b. Such findings are inconsistent with the finding that the transactions between the parties were security devices.

The District Court, in its Memorandum Decision (Appendix 25) stated that appellee had advanced three theories of recovery:

1. Express assumption by the appellee of the option contract of March 4, 1964;

2. Transfer by the bankrupt with actual intent to defraud his creditors;

3. Transfer by bankrupt without fair consideration within one year of bankruptcy while insolvent (constructive fraud) (R. 49, Appendix 25).

The contentions of the appellee do not include a contention that there was any transfer by the bankrupt in actual or constructive fraud of his creditors. The only contentions in the Pre-Trial Order on the question of fraud are as follows:

"* * * *If the transaction culminating in said agreement* (*of March* 4, 1964) *be construed as an agreement* requiring the bankrupt to make an actual payment * * * then, in view of the circumstances existing and of which the defendant had knowledge, such transactions constituted a transfer made or incurred without fair consideration by the bankrupt who was then insolvent * * *" (R. 39, L. 2-10) (emphasis added) and

"* * * If the transaction culminating in said agreement (of March 4, 1964) *be construed as an agreement* requiring the bankrupt to make an actual payment * * * such transaction constituted a transfer made or incurred with intent to hinder, delay or defraud creditors and was fraudulent * * *." (R. 39, L. 19-28) (Emphasis added).

These contentions made by the appellee were in line with his theory that the agreement of March 4, 1964,

was in fact an option and any rights of appellee against the appellant rested upon enforcement of the agreement of March 4, 1964.

Since the District Court held that the appellee had not assumed the option contract of March 4, 1964, the contentions as to its construction contained in the Pre-Trial Order become immaterial.

Not only were there no contentions by appellee that a transaction occurred within one year of bankruptcy, by which the bankrupt transferred his equitable interest in the corporate stock to appellant in return for cancellation of indebtedness, there was no evidence of any such transfer.

The only transaction between the appellant and bankrupt within one year of bankruptcy was the transaction of March 4, 1964 which the District Court found to be a security device.

The finding of the District Court that such a voidable transfer occurred within one year of bankruptcy loses any weight it might otherwise have, because the District Court, in its Memorandum Decision, says:

> "*Although the Court is unable to fix the precise date* the Court does find * * *" (R. 51, Appendix 27) (emphasis added).

If the District Court had regarded the transaction of March 4, 1964 as being a transfer in fraud of creditors, there would have been no uncertainty as to date. There simply was no evidence of any other transaction between the parties within one year of bankruptcy, and the finding of the Court is unsupported by any evidence.

CONCLUSION

The inevitable conclusion to be drawn from the record in this case, is that facts and logic were disregarded by the District Court and that the judgment in favor of the appellee must be reversed.

Respectfully submitted,

C. X. Bollenback
Attorney for Appellant
Alonzo W. Dering

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rule 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. X. Bollenback

APPENDIX A

MEMORANDUM DECISION

The trustee has sought to recover a share of the proceeds of the sale of Dering Industries, Inc. to Moncrief-Lenoir. Three theories of recovery have been advanced: (1) express assumption by the trustee of the option contract of March 4, 1964, 11 U.S.C. §110(b); (2) a transfer by the bankrupt with actual intent to hinder, delay or defraud creditors, 11 U.S.C. § 107(d)(2)(d); and (3) a transfer by the bankrupt without fair consideration within one year prior to bankruptcy and while insolvent, 11 U.S.C. § 107(d)(2)(a).

After weighing the evidence and studying the exhibits, the court has concluded that the trustee has failed to sustain the burden of proof as to assumption of the option agreement of March 4, 1964. The only evidence introduced by the trustee was that notice was given that a claim was being made to the proceeds of the sale, but a mere claim to the proceeds does not give fair or adequate notice of assumption of the contract since such a claim is also fully consistent with other theories of right to the proceeds, such as fraudulent transfer, unlawful preference or equitable ownership. Even allowing the requested amendment to plaintiff's pretrial order contentions to conform to the proof, the court is not prepared to find that notice of assumption was waived by the defendant by the mere statement of his position that the bankrupt had no right to the proceeds because he had not exercised the purchase option by May 31, 1964.

The court is also of the opinion that the trustee has failed to carry his burden of proof as to the claim that the bankrupt's interest in the 100 shares of stock was transferred with an actual intent to hinder, delay or defraud creditors. However, the court does find that the trustee has succeeded in proving a transfer without fair consideration within one year prior to bankruptcy and while the bankrupt was insolvent.

The entire pattern of this series of "sales" and "options to repurchase" strongly indicates that the transactions were in fact merely security devices for loans made to the bankrupt. The "options" provided for the payment of interest and on at least one occasion, December 6, 1962, adjustment was made to allow for interest. On that occasion the bankrupt "exercised" the "option" and "repurchased" 22 shares, but paid a price which under the option agreement was equivalent to the price for 30 shares. The defendant, with commendable candor, testified that the disparity was to allow for interest paid him by the bankrupt. Had the options provided only for a fixed purchase price a closer question would be presented, but interest by definition is the price per unit time paid by the borrower on what he borrows. Furthermore, the stock was never transferred to the defendant on the corporation's books. In addition, the bankrupt continued to receive a salary for his services on the same terms as before the purported sale of his stock. This salary was based on the profits of the corporation and inasmuch as no dividends were ever declared, the salary appears to have been primarily a device for the distribution of corporate profits. The continuance of the bank-

rupt's share of the profits, unaltered by the "sale" of his stock to the defendant, is further indication of his retention of an equitable interest in the stock. Adopting the theory most favorable to the defendant, the court can at best find the transaction to be a security device.

Although the court is unable to fix the precise date, the court does find that within one year prior to the adjudication of bankruptcy on April 16, 1964, and at a time when the bankrupt was already insolvent, the bankrupt transferred to the defendant his equitable interest in the 100 shares of Dering Industries stock. The only consideration for the transfer was the cancellation of the debt and accrued interest.

The parties have agreed that the defendant realized $50,240 from the sale of Dering Industries, Inc. and the court finds this to be the fair market value at the time of the transfer of the bankrupt's equitable interest. The trustee is entitled to one-half of that amount minus $10,600, the agreed amount of the debt and accrued interest, or $14,520. The court further finds that the defendant is entitled to a credit of $400 for the value of his services rendered in winding up the affairs of the corporation.

Judgment will be entered in favor of the plaintiff trustee for $14,120.

Plaintiff's counsel will prepare findings, conclusions and judgment to be submitted to this Court not later than July 19, 1965. Defendant's counsel shall have five days thereafter to note any objections.

DATED this 8th day of July, 1965.

APPENDIX B

Appellee-Plaintiff's Exhibits

Exhibit No	Identified	Offered	Received	Rejected
1	102	102	102	
2	33	33		35
3	35	35-6		38
4	50	50	50	

Appellant-Defendant's Exhibits

16	11	11-12	
17	24-25		
20 (a)(b)(c)	16, 56	57	57
21	56	57	57
22	57-58	58	58
24	61	61	62
25	61	61	62
27	62	62	63
28	62	62	63
29	27, 63	68	
30	68	68	68
31	68	68	68
32	68	68	68
33	70	70	70
34	70	70	70
35	70	70	70
36	75		77
37	68-69	69	69
39	68-69	69	69
40	68-69	69	69
41	24, 70	71	71
42	24, 70	71	71

No. 20567

United States
COURT OF APPEALS
for the Ninth Circuit

ALONZO W. DERING,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of Eldon P. Dering, bankrupt,

Appellee.

APPELLEE'S ANSWERING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

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No. 20567

United States
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ALONZO W. DERING,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of Eldon P. Dering, bankrupt,

Appellee.

APPELLEE'S ANSWERING BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

STATEMENT OF JURISDICTION

The appellee-plaintiff, Everett H. Williams, trustee in bankruptcy of Eldon P. Dering, bankrupt, commenced this suit in the United States District Court for the District of Oregon to recover certain moneys from appellant-defendant, Alonzo W. Dering. Jurisdiction was based upon Section 67(e) of the Bankruptcy Act, 11 U.S.C. 107(e).

After a trial before the Honorable William T. Beeks, Judge of the United States District Court, and a hearing on objections of the appellant to Findings of Fact and Conclusions of Law proposed by the Court, a judgment based upon Findings of Fact and Conclusions of Law was entered in favor of the appellee in the sum of $14,-120.00, together with interest at the rate of 6% from June 30, 1964, and costs and disbursements. This is an appeal by the appellant from said judgment.

STATEMENT OF FACTS

The appellant and his brother, the bankrupt (also known as Mike Dering), organized Dering Industries, Inc., an Oregon corporation, in 1951. The corporation, which was engaged in the manufacture and sale of aluminum fence gates, was managed by the appellant from the time of its inception (Tr. 6). It maintained offices in an office and warehouse building owned by the bankrupt, who also rendered services for the corporation when the appellant was away (Tr. 6). The appellant and the bankrupt were officers and directors of the corporation until its sale in 1964 (Tr. 23).

Two hundred shares of capital stock were issued, 100 shares each to the appellant and the bankrupt. On September 30, 1951, the appellant and the bankrupt executed reciprocal options for the purchase of the stock of the other. Said options are set forth in the Pre-Trial Order (R. 28-30). The appellant and the bankrupt each held separate stock certificates for 100 shares of stock until December 6, 1961 (Tr. 6).

On December 6, 1961, the bankrupt being in financial difficulties and in need of money, obtained $10,000 from the appellant. At the same time the bankrupt endorsed and delivered his stock certificate to the appellant who in turn executed and delivered to the bankrupt a document entitled "OPTION TO PURCHASE STOCK." This document, set forth in the Pre-Trial Order (R. 30-31), purported to give the bankrupt the exclusive right and option for a period of 180 days from the date thereof to purchase the 100 shares of stock for $10,000 plus interest at the rate of 6 percent. The stock certificate was not transferred nor a new certificate issued on the books and records of the corporation at that time (Tr. 10).

On June 6, 1962, the bankrupt repaid the appellant the sum of $3,000 (R. 31; Tr. 11). On the same date the appellant executed and delivered to the bankrupt another document entitled "OPTION TO PURCHASE STOCK," set forth in the Pre-Trial Order (R. 31), purporting to give the bankrupt the exclusive right and option for a period of 180 days from the date thereof to purchase 70 shares of stock for the sum of $7,000 plus interest at the rate of 6 percent.

On December 6, 1962, the bankrupt repaid the appellant the further sum of $3,000 (R. 32; Tr. 11, 13). On the same date the appellant executed and delivered to the bankrupt a document likewise entitled "OPTION TO PURCHASE STOCK," set forth in the Pre-Trial Order (R. 32), purporting to give the bankrupt the exclusive right and option for a period of 180 days from

the date thereof to purchase *48* shares of capital stock for the sum of $4,800 plus interest at the rate of 6 percent.

Notwithstanding these repayments the appellant continued to hold the stock certificate originally issued to the bankrupt and endorsed to the appellant on December 6, 1961, and no new certificates of stock were issued either to the appellant or the bankrupt on these two occasions (Tr. 10).

The so-called option given the bankrupt after the first repayment of $3,000 on June 6, 1962, reduced the amount of stock which the bankrupt had a right to purchase from 100 shares to 70 shares. Appellant's explanation was that the bankrupt had "repurchased" 30 shares at the rate of $100 per share (Tr. 11). The so-called option given on the occasion of the second repayment of $3,000 on December 6, 1961, reduced the amount of shares which the bankrupt had a right to repurchase from 70 to 48 shares; that is the bankrupt, according to appellant, had this time "repurchased" only 22 shares for $3,000. Appellant explained the difference in the number of shares received by admitting that some portion of the amount received by him had been applied to interest (Tr. 13).

On February 20, 1963, the bankrupt, again being in need of money, obtained $5,850 from the appellant (R. 32; Tr. 13), who at the same time executed and delivered to the bankrupt a document entitled "OPTION," set out in full in the Pre-Trial Order (R. 32-34), purporting to give the bankrupt an option to purchase 100

shares of stock on the terms and conditions set forth in said document. At this time the certificate originally issued to the bankrupt was cancelled and a new certificate was issued to the appellant (R. 34; Tr. 13).

On March 4, 1964, there was a further transaction between the parties which did not involve any transfer of funds. At that time both parties executed the final document relating to the corporation and its stock, entitled "AGREEMENT — BETWEEN ALONZO W. DERING AND ELDON P. DERING, set forth in the Pre-Trial Order (R. 34-35), which agreement provided for the sale or liquidation of the corporation. Unlike the four prior documents, all of which were designated "OPTIONS,"* the document dated March 4, 1964, is entitled "AGREEMENT." Also it is the only document to which both parties were signatories, all of the so-called option documents being executed solely by the appellant.

What were the circumstances obtaining at that time, that is March 4, 1964? The bankrupt had been in financial difficulties for some time. A number of lawsuits against him had proceeded to judgment. The bankrupt had been forced to cease his rose-growing and nursery business, and also to sell his inventory and surrender his office and warehouse by November 1, 1963 (R. 36; Tr. 14, 17-19). In fact, he had terminated his operations in the summer, or in any event by September of 1963 (Tr. 55). On November 1, 1963, and thereafter, he

---

* These documents dated December 6, 1961, June 6, 1962, December 6, 1962, and February 20, 1963, are sometimes hereinafter referred to as the so-called option documents.

was admittedly insolvent (R. 36; Tr. 17). The appellant for a long time had been aware of his brother's financial difficulties and of his insolvency on November 1, 1963, and thereafter (R. 37; Tr. 17).

Further, on that date, that is March 4, 1964, Dering Industries, Inc. had in excess of $20,000 in cash in the bank plus accounts receivable, inventory and equipment, and no outstanding debts of any kind (Tr. 27, 114-115; Ex. 22). Moreover, it had a franchise from Life-Time Gate Co., a subsidiary of Moncrief-Lenoir, to whom the stock of the corporation was thereafter sold. The franchise was, and for two or three years prior thereto had been, valued by the appellant at $25,000 (Tr. 64-66, 79-80) and was almost immediately thereafter sold on March 27, 1964, for $25,000, that is a value of $25,000 was placed on the franchise, in addition to the value of the other assets, in determining the purchase price of the stock (Tr. 27, 78-80; Exs. 29, 34).

By March 4, 1964, the appellant had determined, because of the bankrupt's financial difficulties and the impending loss of the building in which the corporation's offices were located (Ex. 22), to sell or liquidate the corporation. The day previous, on March 3, 1964, he had written to Moncrief-Lenoir (Ex. 22) relative to a possible sale. After some indication that Moncrief-Lenoir was not interested in the purchase of the corporation (Tr. 28, Ex. 28) and some negotiations between the appellant and Mr. Zanley Galton, president of Western Wire Works (Tr. 28-30), an agreement for the sale of the stock of the corporation, including the sum of

$25,000 for the franchise, was reached in a long-distance telephone conversation between the appellant and Frank Lenoir and confirmed by letter the following day, that is, March 27, 1964 (Tr. 27-28, 63; Ex. 29).

It would appear there was no question concerning the ultimate consummation of the purchase and sale transaction and the appellant took certain steps and immediately corresponded with the purchaser relative to various matters predicated thereon (Ex. 30, 31). Possession of the physical assets was taken by the purchaser on or about June 1, 1964 (Tr. 32), although the final determination of the purchase price and payment thereof was not made until July 1, 1964, when the appellant received the total sum of $50,241 (Tr. 115; Ex. 34).

In the meantime the bankrupt filed a voluntary petition in bankruptcy on April 16, 1964 and was adjudicated a bankrupt (R. 27).

The salaries and profits of the corporation were distributed to the appellant and the bankrupt on an annual basis at the close of each fiscal year (Tr. 53, 55). As a practical matter, appellant admitted that salaries were adjusted at the close of each year in an effort to absorb all of the profits of the corporation (Tr. 55).

The appellant has conceded that profits were shared with the bankrupt until the close of the fiscal year on May 31, 1963 at which time the bankrupt received $3,000 (Tr. 21-22). The appellant testified that only $600 was paid the bankrupt for the fiscal year ending May 31, 1964, despite the fact the bankrupt admittedly performed no services subsequent to September, 1963.

There were no minutes or other records providing any basis or explanation for any profit or salary adjustments subsequent to May 31, 1963 (Tr. 23-24). It should be noted that of the $600 payment to the bankrupt for the final year the portion for the period commencing with June 1, 1963, and ending with the date the bankruptcy petition was filed was paid to appellee as trustee in bankruptcy (Tr. 77-78), and only the portion of the salary payment for the period subsequent to the filing of the petition was paid to the bankrupt (Tr. 77-78).

As appellee has pointed out in his brief (Br. 16), the schedules filed by the bankrupt did not list the appellant as a creditor (Ex. 1). Neither did the bankrupt's schedules list the corporation stock or the agreement of March 4, 1964 among the assets (Tr. 103, Ex. 1).

SUMMARY OF ARGUMENT

The appellant has assigned three specifications of error with respect to which the appellee's argument is as follows:

1. Specification of Error 1.

The four so-called option documents dated December 6, 1961, to February 20, 1963, inclusive, were security devices for loans made by the appellant to the bankrupt.

a. The evidence clearly supports such finding.

b. The trial court properly made its findings upon the basis of the evidence presented and not upon the theory upon which the parties may have tried the case.

Hormel v. Helvering, 312 U.S. 522, 61 S. Ct. 719, 85 L. Ed. 1037 (1940).

United States v. Bess, 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958).

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).

Massachusetts Bonding & Insurance Co. v. State of New York, 2 Cir., 259 F.2d 33 (1958).

2. Specification of Error 2.

The agreement of March 4, 1964, superseded any and all prior agreements, options and understandings and was made in contemplation of the sale or liquidation of the stock or assets of the corporation; and accordingly the trial court properly disregarded the appellant's contention based upon the option dated September 30, 1951.

3. Specification of Error 3.

a. The evidence clearly supports the findings that within one year prior to the adjudication in bankruptcy and at a time when the bankrupt was insolvent, he transferred his equitable interest in the 100 shares of corporation stock to the appellant, that said transfer was without fair consideration and that the value of the bankrupt's equitable interest at the time of transfer was $25,120.

b. These findings are not inconsistent with the finding that the four so-called option documents of December 6, 1961, to February 20, 1963, inclusive, were security devices. The agreement of March 4, 1964, was not a security device but an agreement for sale or liquidation of the corporation.

c. The appellant's contentions as to the Pre-Trial Order, the inadequacy of the appellee's contentions and Finding 10 have no validity.

(1) A pre-trial order is to be liberally construed and the court may consider issues not framed therein and make findings of fact relative thereto.

3 Moore, Federal Practice, 2d Ed. 1132.

Smith Contracting Corp. v. Trojan Const. Co., Inc., 10 Cir., 192 F.2d 234 (1951).

Rosden v. Leuthold, C.A., D.C., 274 F.2d 747 (1960).

Scott v. Spanjer Bros., Inc., 2 Cir., 298 F.2d 928 (1962).

Century Refining Co. v. Hall, 10 Cir., 316 F.2d 15 (1963).

Clark v. Pennsylvania Railroad Company, 2 Cir., 328 F.2d 591 (1964).

(2) A pre-trial order may be amended to permit a court to make findings and the court may amend by making findings.

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).

American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 9 Cir., 292 F.2d 640 (1961).

Interstate Plywood Sales Co. v. Interstate Container Corp., 9 Cir., 331 F.2d 449 (1964).

Brucker v. United States, 9 Cir., 338 F.2d 427 (1964).

(3) A pre-trial order is amended by implied consent by the introduction of evidence without objection and issues so tried are treated as if raised in the pleadings.

Southern Pacific Co. v. Libbey, 9 Cir., 199 F.2d 341 (1952).

Shelley v. Union Oil Co. of Cal., 9 Cir., 203 F.2d 808 (1953).

Glens Falls Indemnity Company v. United States, 9 Cir., 229 F.2d 370 (1955).

Kirk v. United States, 9 Cir., 232 F.2d 763 (1956).

Hall v. National Supply Co., 5 Cir., 270 F.2d 379 (1959).

Rosden v. Leuthold, C.A., D.C., 274 F.2d 747 (1960).

June T., Inc. v. King, 5 Cir., 290 F.2d 404 (1961).

Securities and Exchange Commission v. Rapp, 2 Cir., 304 F.2d 786 (1962).

3 Moore, Federal Practice, 2d Ed. 983, 984.

(4) Where issues are tried a court must make findings thereon.

3 Moore, Federal Practice, 2d Ed. 996.

Securities and Exchange Commission v. Rapp, 2 Cir., 304 F.2d 786 (1962).

The appellee further makes the following

4. Argument for Affirmance of Judgment.

The judgment of the trial court must be affirmed unless its findings of fact are clearly erroneous.

Fireside Marshmallow Co. v. Frank Quinlan Const. Co., 8 Cir., 199 F.2d 511 (1952).

American Pipe & Steel Corp. v. Firestone Tire & Rubber Co., 9 Cir., 292 F.2d 640 (1961).

ARGUMENT

1. Answer to Appellant's First Specification of Error

Appellant's first specification of error is:

"The District Court erred in finding:

'4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt.' (R. 88 Findings etc.)

on the grounds and for the reasons:

"a. The evidence was insufficient to establish the purported fact;

"b. Such finding was inconsistent with the theory upon which the appellee tried the case."

In his argument thereon the appellant sets forth some factors to be considered in determining whether a particular transaction is a sale with an option back or a security transaction. His statement of the factors consists of generalized statements of language appearing in *Blue River Sawmills Ltd.* v. *Gates,* 225 Or. 439, 358 P.2d 239 (1960). The appellant then suggests that the evidence should be tested in the light of the factors enumerated, proceeds to make a few brief references to some of the testimony and the documentary evidence and to the memorandum decision of the trial court, and concludes that "the preponderance of the evidence does

not establish that the various transactions were security devices" (Appt's. Br. 10, 18).

It is submitted that the appellant has either failed to note or deliberately overlooked a substantial amount of testimony and documentary evidence, including provisions of the four so-called option documents, which clearly establish the contrary. Of greater importance is the fact, which the appellee wishes to emphasize, that the appellant has erroneously interpreted Finding 4 as including the agreement of March 4, 1964 among the "option documents * * * intended to constitute security devices for loans made by the defendant to the bankrupt" (R. 88). It should be noted that Finding 4 relates to "transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant" and that no transfer of funds was involved in the March 4, 1964, transaction. It is undoubtedly because of this erroneous interpretation of Finding 4 that the appellant urges as his second specification of error that the District Court erred in refusing to give force or effect to the option agreement of September 30, 1951, and the appellant's exercise thereof (Appt's. Br. 10, 19), and that he contends in his third specification of error that Findings 6 and 8 on the one hand are inconsistent with Finding 4 on the other (Appt's. Br. 10, 21). The appellee will discuss this observation in detail in his answer to the appellant's third assignment of error. The appellee at this point deems it sufficient to observe that the agreement of March 4, 1964, was not intended as a security device nor was it regarded as such

by the trial court when he entered the findings of fact, conclusions of law and judgment.

Let us consider some of the evidence. There were four so-called option documents executed betwen December 6, 1961, and February 20, 1963. Each of these documents fixed the price to be paid to the appellant for the "repurchase" of the designated number of shares of stock referred to therein at an amount precisely equal to $100 per share plus interest at the rate of 6% per annum. The appellant testified that he had charged interest when the second repayment of $3,000 was made by the bankrupt on December 6, 1961 (Tr. 13). How the interest was computed he did not know. In any event, $3,000 was paid for 22 shares purportedly repurchased by the bankrupt, an amount in substantial variance from the price of $100 per share specified in the so-called option document dated June 6, 1962. Likewise, the amount advanced by the appellant to the bankrupt on February 20, 1963, $5,850, was at substantial variance from the price of 52 shares at that time presumably again "purchased" from the bankrupt.

The recital in the so-called option document of June 6, 1962 that the bankrupt had theretofore transferred 70 shares to the appellant and the similar recital in the so-called option document dated December 6, 1962 that the bankrupt had theretofore transferred 48 shares to the appellant are inconsistent with what the appellant has contended, namely that he purchased 100 shares from the bankrupt on December 6, 1961, and that the bankrupt had repurchased 30 shares and an additional

22 shares during 1962. These recitals, if they are at all meaningful, are consistent only with pledges of 70 and 48 shares respectively and the word "transferred" in the recitals properly should be read as "transferred as collateral security."

Notwithstanding the purported purchase of 100 shares of the bankrupt's stock originally on December 6, 1961, the purported repurchases of 30 shares and 22 shares by the bankrupt during 1962 and the purported repurchase of 52 shares by the appellant on February 20, 1963, the bankrupt continued to share in profits until June, 1963 (Tr. 21-22). This sharing in profits, as noted by the trial court in its memorandum opinion, is inconsistent with the appellant's theory of a purchase and sale of the bankrupt's stock and is consistent only with the analysis of the court and Finding 4 that these transactions involved loans and that the so-called option documents were security devices.

The appellant's observation in his brief on page 18 that "the undisputed evidence was that at the yearly corporate meeting after the February 20, 1963 transaction, the compensation of the bankrupt, to be received by him from Dering Industries, Inc. was reduced from $3,000.00 per year to $600.00 per year (Tr. 77)" is simply not corect. The minutes of the meetings are in evidence (Exs. 41, 42). The trial court made express inquiry relative thereto (Tr. 23) and counsel for the appellant stated that there was no provision in the minutes relative to compensation or profits (Tr. 23). Further, Exhibit 22, being a letter dated March 3, 1964, from the appellant

to Moncrief-Lenoir specifically states that the appellant still kept the bankrupt on the payroll and "divide the profits with him." Finally, profits as noted were adjusted at the close of each year (Tr. 53, 55). The reduction of the bankrupt's share to $600.00 was a unilateral action of the appellant (Tr. 22-23), made in June, 1964, after the agreement of March 4, 1964, after the petition in bankruptcy had been filed on April 16, 1964, and after the appellant knew that a major portion of the salary or profits received by the bankrupt would have to be paid to the trustee in bankruptcy and not to the bankrupt himself.

The appellant has observed in his brief (Br. 16) that the statement of affairs filed with the petition in bankruptcy recited that the option had been released (Ex. 1) and that the appellant was not listed as a creditor in the schedules filed in bankruptcy (Ex. 1). With respect thereto it is sufficient to note that these facts are completely consistent with the sale and transfer of the stock to the appellant on March 4, 1964.

The only other observation made by appellant is the fact that the bankrupt was not called as a witness. As the defendant admitted, the bankrupt had suffered a heart attack in 1955 (Tr. 15), he had been ill on various occasions subsequently thereto, and for a period the bankrupt's son Patrick had run the business (Tr. 14-15) and he was and had been, at least from October, 1964, in Phoenix, Arizona (Tr. 5). It must further be presumed that the bankrupt had no particular interest in the outcome of the litigation except such as might derive from his family relationship to the appellant.

The financial needs of the bankrupt, a fact sought to be glossed over by the appellant by his observation that "the appellant knew bankrupt wanted money but did not know the reason" (Appt's. Br. 16) is material in considering whether these transactions were loans or otherwise. In *Blue River Sawmills Ltd.* v. *Gates*, 225 Or. 439, 461, 358 P.2d 239 (1960), cited by the appellant, the fact that the party seeking funds is in financial distress is recognized as a highly important consideration. Thus, the following appears at 358 P.2d 249:

> "In Umpqua Forest Industries v. Neenah-Ore. Land Co., supra, 188 Or. at page 633, 217 P.2d at page 230, we quoted with approval the following from 59 C.J.S. Mortgages Section 42, p. 78, as the rule upon which appellants rely:
>
> > " 'If the grantor of a deed absolute in form, but alleged to have been intended as a security, was financially embarrassed at the time of its execution, being sorely pressed for money and, therefore, at the mercy of his creditor and unable freely to dictate the terms of his security, this circumstance will be considered as tending to show the intention to create a mortgage.' "

It may be pertinent to observe that in that case the court, which held there had been a sale, specifically observed that it found nothing in the record disclosing that either the plaintiff, Blue River Sawmills, or one Shroyer was being sorely pressed for money or at the mercy of any creditor at the time negotiation was had with Gates. In the case before the Court however, the situation was clearly to the contrary. As the appellant has admitted and as the bankruptcy schedules (Ex. 1)

clearly show, the bankrupt, who had been possessed of substantial assets and was a large rose grower and nursery operator, had been in financial distress for a long period of time, was forced to terminate those operations and ultimately file a petition in bankruptcy.

The second contention in support of appellant's first specification of error is that the finding was inconsistent with the theory upon which the appellee tried the case.

Without conceding this contention, the trial court quite properly made its findings upon the basis of the evidence presented and not upon the theory upon which the parties may have tried the case. *Hormel* v. *Helvering,* 312 U.S. 552, 61 S. Ct. 719, 85 L. Ed. 1037 (1940); *United States* v. *Bess,* 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958); *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.,* 8 Cir., 199 F.2d 511 (1952); *Massachusetts Bonding & Insurance Co.* v. *State of New York,* 2 Cir., 259 F.2d 33 (1958).

In *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.* the following appears at p. 514:

> "There is no doubt that both parties formulated their pleadings and entered upon the trial upon the theory that the contract was still in effect. But that fact in itself would not necessarily preclude the court from treating the pleadings as amended to conform to the issues presented by the evidence. Rules 15(b) and 54(c) FRCP (citations omitted)"

In *Masachusetts Bonding & Insurance Co.* v. *State of New York* the following appears at p. 40:

"On this issue the United States is met with the contention that it waived or lost its claim by failing to assert it before the Referee or the district court. *It appears from the record that this 'lien theory' was never urged below.* It is also clear, however, that the formal claim presented in the proceeding by the U. S., and *other portions of the record, contained sufficient facts to sustain the lien and the priority.*" (Emphasis supplied)

2. Answer to Appellant's Second Specification of Error

The appellant's second specification of error is that the District Court erred when it "refused to give force or effect to the option of September 30, 1951, and appellant's exercise thereof." The issue raised by this specification of error, which was argued by the appellant at the time of the hearing of his objections to the Findings of Fact and Conclusions of Law proposed by the court, also depends for its determination upon the interpretation given to the March 4, 1964, agreement and to this extent does not present a need or different basis for the appellant's position.

The appellant's argument in support of this specification of error is that if the transactions including that of March 4, 1964, were mere options then the original option agreement in favor of the appellant dated September 30, 1951, when the corporation was organized, was still in full force and effect; further that the appellant sought to exercise his rights under that option by letter dated June 30, 1964, to the bankrupt, with a copy to the Referee in Bankruptcy (Ex. 36); and finally that

in view thereof the rights of the bankrupt, and the appellee-trustee as successor in interest of the bankrupt, were limited to the book value of the stock less the sums theretofore received by the bankrupt.

It should first be noted that the alleged exercise on June 30, 1964, of rights under the option instrument dated September 30, 1951, occurred after the bankruptcy petition had been filed on April 16, 1964, after the trustee had asserted rights under the agreement of March 4, 1964 (Tr. 84, 110-111), and after it clearly appeared that there was a conflict between the appellant and appellee (Tr. 110-111). Accordingly, the attempted exercise by the appellant of rights under the option of September 30, 1951, was merely a self-serving gesture.

The position of the appellee relative to the option of September 30, 1951, and the four so-called option documents of December 6, 1961, to February 20, 1963, inclusive, is clearly set forth in the contention made by him in the Pre-Trial Order (R. 38) reading in part as follows:

> "3. The agreement of March 4, 1964, relative to the sale or liquidation of Dering Industries, Inc. must be construed as superseding any and all prior agreements, options, understandings and arrangements between the defendant and the bankrupt, the parties thereto. It was made in contemplation of the sale or liquidation of the capital stock or assets of the corporation by the defendant, and a definite understanding and agreement was reached for a division of the proceeds equally between the parties except that the defendant would receive out of the

bankrupt's share the sum of $10,000.00 plus interest from June 1, 1963."

The court adopted the appellee's contention in Finding 6 (R. 88) contrary to the view expressed by the appellant in his brief (Br. 21). Thus the court, paraphrasing the language of 11 U.S.C. 107d(2)(a), found that there had been a transfer of the bankrupt's equitable interest in the corporation stock to the appellant *within one year prior to* the filing of the petition and adjudication in bankruptcy on April 16, 1964. This finding is supported by the analysis of the March 4, 1964, agreement hereinafter made in the appellee's answer to the appellant's third specification of error. It is submitted that the appellee's analysis of the agreement is correct and that the appellant's attempted construction of Finding 4 to the effect that the March 4, 1964 agreement was a mere option is incorrect. It is clear therefore that the option dated September 30, 1951, had been superseded and the trial court properly disregarded the appellant's contention based thereon.

3. Answer to Appellant's Third Specification of Error

The appellant's third specification in error is:

"The District Court erred in finding that:

'6. Within one year prior to the adjudication of bankruptcy on April 16, 1964, at a time when the bankrupt was insolvent, the bankrupt transferred to the defendant his equitable interest in the stock of the corporation. The only consideration for the transfer was the cancel-

lation of the bankrupt's indebtedness and accrued interest.'

'8. The transfer and surrender of the bankrupt's equitable interest in the 100 shares of corporation stock, which had a fair market value of $25,120.00 in consideration of the cancellation of the bankrupt's indebtedness and accrued interest thereon, aggregating $10,600.00 was without fair consideration.' "

on the following grounds:

"a. There was no evidence to support such findings;

"b. Such findings are inconsistent with the finding that the transactions between the parties were security devices."

Although the appellant's grounds for his position are that there was no evidence to support such findings and that the findings are inconsistent with Finding 4 his argument is not related thereto. In appellant's brief there are no material recitals of testimony or other evidence relative to Finding 6, and absolutely no mention of any evidence relative to Finding 8, nor is there any discussion of the claimed inconsistency. The appellant's argument (Br. 22-23) is based entirely upon the Pre-Trial Order, the claimed inadequacy of the contentions of the appellee and Finding 10 that the appellee did not give effective notice of the assumption of the agreement of March 4, 1964 (R. 89).

The appellee will first direct consideration to the findings themselves and the evidence relevant thereto.

Let us assume for the moment that the so-called option document of February 20, 1963, was in fact an option and that the appellant had acquired all of the ownership rights in the stock originally owned by the bankrupt, save and except a mere option in the bankrupt to repurchase. The purported option was by the provisions of paragraph I unlimited as to time so long as the appellant continued to own said stock and so long as the bankrupt paid interest in the amount of $600 annually. Nevertheless, that document contained other provisions whereby appellant could neither terminate the bankrupt's rights in the stock or compel him promptly to repurchase. That provision provided for the giving of 15 days' notice by the appellant in the event of a desire to sell.

When the March 4, 1964 agreement was entered into the appellant had already determined to sell or liquidate the corporation (Ex. 22). If the February 20, 1963 document were in fact a mere option the appellant could simply have given the bankrupt 15 days' notice. There would have been no need to enter into the March 4, 1964 agreement providing for the sale or liquidation of the corporation and the division of proceeds. Why did he not give such notice? Obviously there must have been some reason for his not doing so and entering into the March 4, 1964 agreement. The only explicable reason is that the so-called option documents, including that of February 20, 1963, were not in fact what they purported to be and that the bankrupt in fact had a beneficial interest in the corporation and in 100 shares of stock therein.

When the agreement of March 4, 1964, is examined in the light of the circumstances then prevailing, it provides some interesting observations. The so-called option documents of December 6, 1961, to February 20, 1963, inclusive, at least contemplated a continuing corporation and purported to provide for an option to repurchase stock in such a corporation. The March 4, 1964, agreement specifically provided for its sale or liquidation. Thus, it specifically provided as follows:

> "THIS AGREEMENT CANCELLS [sic] THE OPTION DATED FEBRUARY 20th, 1963, AND SIGNED BY ALONZO W. DERING."

That this was its sole objective except for the apportionment of the proceeds to be derived therefrom is most emphatically evidenced by these further provisions:

> "THIS AGREEMENT IS BEING EXECUTED FOR THE PURPOSE OF SELLING DERING INDUSTRIES, INC., OR IN THE EVENT THAT A SALE IS NOT MADE: TO LIQUIDATE DERING INDUSTRIES, INC. THIS SALE OR LIQUIDATION TO BE STARTED THIS DATE AND BE COMPLETED OR IN THE PROCESS OF COMPLETION BY MAY 31st, 1964.
>
> "IT IS AGREED BETWEEN ALONZO W. DERING AND ELDON P. DERING THAT THIS AGREEMENT WILL BE EFFECTIVE AND NEITHER PARTY TO THIS AGREEMENT CAN STOP THE PROCEEDINGS ONCE STARTED."

The agreement then contains a provision specifying how the proceeds from the sale or liquidation are to be divided and including four subparagraphs. The second

subparagraph, upon which the appellant necessarily relies for his contention that this agreement was an option, states the bankrupt agrees to purchase 100 shares of stock for $10,000 plus accumulated interest from June 1, 1963, to the date of purchase which is to be prior to the date of sale or completion. However, subparagraph 4 provides "*the proceeds from the sale or liquidation of Dering Industries, Inc. are to be divided equally.*" (Emphasis supplied)

The following paragraph sets forth the intent of the agreement, namely to return $20,000 to the appellant, Alonzo W. Dering, plus interest at 6 percent on $10,000. The paragraph further indicates that the excess of over $20,000 is to be equally divided between the appellant and the bankrupt.

It is conceded that some of the provisions of this agreement are ambiguous and in conflict. However, it must be remembered the agreement was drawn by the appellant himself (Tr. 19). It is submitted that the only consistent construction of the agreement is that the appellant was to receive $20,600 and that any additional proceeds were to be apportioned between the parties. With respect thereto the appellant contends that the bankrupt first had to pay the appellant the sum of $10,600 and do so prior to the sale and liquidation of the corporation; and in that event, *and only in that event,* would the bankrupt be entitled to receive one-half of the total proceeds. For this contention to have merit the payment of $10,600 by the bankrupt must be considered a mandatory requirement and the failure of the bankrupt, or the appellee-trustee as his successor, to make such

payment prior to May 31, 1964, must be held to have resulted in a forfeiture of any of their rights to share in the benefits of the sale. However, a court of equity abhors forfeitures.

To declare a forfeiture in this instance would appear to be particularly objectionable. On March 4, 1964, the corporation had in excess of $20,000 in cash as well as other assets free and clear of any and all indebtedness (Tr. 27, 114-115; Ex. 22) and shortly thereafter the appellant realized some $50,240 therefor. Accordingly, there was not the slightest question that there would be $20,600 available for distribution to the appellant ahead of any apportionment of the proceeds to the bankrupt and further that the appellant, since he asserted ownership and control of the corporation (Tr. 14, 25), was in a position to insure that he would first receive such amount. Under such circumstances tender of payment is excused and unnecessary and equity will not require the performance of a useless act.

Also at that time, to defendant's knowledge, the bankrupt had been insolvent at least from November 1, 1963, had been compelled to cease all business operations, was about to file a petition in bankruptcy and was, as both he and defendant well knew, unable to raise the sum of $10,000 plus interest from June 1, 1963. If appellant's contention, under these circumstances, is a proper one, then he and the bankrupt by imposing an impossible condition to the bankrupt's realization of benefits were guilty of entering into an arrangement which would have enabled them to commit fraud under

the provisions of sections 67d (2) of the Bankruptcy Act, 111 U.S.C. 107d (2).

As to Finding 8, the record clearly shows that the appellant received $50,241.47 upon the consummation of the transaction with Moncrief-Lenoir (R. 36; Tr. 115; Ex. 34).

It may be that the precise value of the stock on March 4, 1964, does not appear. However, the appellant's letter of March 3, 1964, to Moncrief-Lenoir (Ex. 22) shows that the corporation then had in excess of $20,000 in cash plus inventory and accounts receivable and a franchise worth $25,000 and no indebtedness of any kind. Further, it appears that the appellant paid himself the sum of $10,000 (Tr. 115) and paid the sum of $600 on behalf of the bankrupt to the appellee as trustee and to the bankrupt (Tr. 77-78). It is submitted that the foregoing clearly establishes that the net worth of the corporation was not less than $50,240 on March 4, 1964, and provides ample basis for the court's finding that a one-half interest in the corporation, that is the bankrupt's equitable interest in 100 shares of corporation stock had a fair market value of $25,120 on that date.

The consideration which the bankrupt received for such one-half interest was a cancellation of his indebtedness, which with accrued interest aggregated $10,600. The March 4, 1964, agreement specifically provides for the cancellation of the so-called option document of February 20, 1963. In view of the court's finding that the February 20, 1963, option document was a

security device, it necessarily follows that the consideration which the bankrupt received for the sale of his equitable interest in the 100 shares of stock, worth $25,120, was simply a cancellation of his indebtedness of $10,600. The court was particularly concerned with this matter as indicated by its interrogation of the appellant's counsel (Tr. 59-60).

Let us now turn to the appellant's argument under this specification of error concerning the contentions of the appellee in the Pre-Trial Order and Finding 10.

The appellee did contend in his first contention that the right and option which the bankrupt had under the February 20, 1963, option document was more than a mere naked option (R. 37). Further, contentions 5 and 6 (R. 39) did raise an issue as to there being a fraudulent and improper transfer on March 4, 1964, within the provisions of section 67d(2) of the Bankruptcy Act, 11 U.S.C., Sec. 107d (2). That the appellant was not misled and was aware that issues were being raised relative to the character of the bankrupt's rights and the nature of the March 4, 1964, transaction is indicated by his second contention (R. 40) and his contentions 7 through 11, inclusive, and the introductory paragraph thereto (R. 41-42). This expressly recognized that the trial court might "hold the options of February 20, 1963, or March 4, 1964, to be security devices" although it evidenced the appellant's erroneous analysis and interpretation of the March 4, 1964, agreement.

However, the appellant's assertions relative to the appellee's contentions and their inadequacy no longer

have any validity. A pre-trial order does not necessarily preclude a court from considering issues not framed therein and making findings of fact relative thereto. Courts have held that a pre-trial order is to be liberally construed and that rigid adherence thereto should not be exacted. 3 Moore, Federal Practice, 2d Ed. 1132; *Smith Contracting Corp.* v. *Trojan Constr. Co., Inc.*, 10 Cir., 192 F.2d 234 (1951); *Rosden* v. *Leuthold*, C.A., D.C., 274 F.2d 747 (1960); *Scott* v. *Spanjer Bros., Inc.*, 2 Cir., 298 F.2d 928 (1962); *Century Refining Co.* v. *Hall*, 10 Cir., 316 F.2d 15 (1963); *Clark* v. *Pennsylvania Railroad Company*, 2 Cir., 328 F.2d 591 (1964).

If it appears to be necessary to amend a pre-trial order to permit a trial court to make findings, the court may do so by the very act of making such findings. *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.*, 8 Cir., 199 F.2d 511 (1952); *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.*, 9 Cir., 292 F.2d 640 (1961); *Interstate Plywood Sales Co.* v. *Interstate Container Corp.*, 9 Cir., 331 F.2d 449 (1964); *Brucker* v. *United States*, 9 Cir., 338 F.2d 427 (1964).

In *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.*, the following appears at p. 643:

> "However strictly appellee may construe the pre-trial conference order, it is clear that the trial court did not construe it so narrowly. The issues determined by the trial court in deciding this case range beyond the question resolved by Findings 5 and 9. Even if the pre-trial order must be read as narrowly as appellee desires to read it, *it must be considered to have been amended by the trial court's*

findings. That a pre-trial order can be amended in such 'de facto' fashion, without formal amendment, is well established." (Emphasis supplied)

In *Interstate Plywood Sales Co.* v. *Interstate Container Corp.* with reference to the appellant's argument that the matter of price was not involved and had been excluded by the pre-trial order the court said at p. 452:

> "Sales Co. also contends that the pre-trial order entirely removed the issue of price uncertainty from the case. However, the pre-trial order included as an issue whether the contract was 'valid and enforceable.' Since a contract is not 'valid and enforceable' if the element of price is missing, the order was sufficient to present the issue of price uncertainty. *And even if the pre-trial order did not include the issue, the order was capable of 'de facto' amendment by the trial court's findings."* (Emphasis supplied)

In this instance the appellant's argument relative to the appellee's contentions in the Pre-Trial Order is not entitled to consideration, since the situation is one in which the Pre-Trial Order was amended by implied consent pursuant to the provisions of Rule 15(b), F.R. Civ. P., 28 U.S.C. and the court's findings are entirely consistent with the Pre-Trial Order as thus amended.

Implied consent is found by evidence introduced without objection and issues so tried are treated as if they had been raised in the pleadings. *Southern Pacific Co.* v. *Libbey,* 9 Cir., 199 F.2d 341 (1952); *Shelley* v. *Union Oil Co. of Cal.,* 9 Cir., 203 F.2d 808 (1953); *Glens Falls Indemnity Company* v. *United States,* 9 Cir.,

229 F.2d 370 (1955); *Kirk* v. *United States*, 9 Cir., 232 F.2d 763 (1956); *Hall* v. *National Supply Co.*, 5 Cir., 270 F.2d 379 (1959); *Rosden* v. *Leuthold*, C.A., D.C., 274 F.2d 747 (1960); *June T., Inc.* v. *King*, 5 Cir., 290 F.2d 404 (1961); *Securities and Exchange Commission* v. *Rapp*, 2 Cir., 304 F.2d 786 (1962); 3 Moore, Federal Practice, 2d Ed., 983, 984.

In *Shelley* v. *Union Oil Co. of Cal.* testimony relative to contributory negligence was developed both on direct and cross examination. The court gave an instruction thereon although contributory negligence had not been raised by the answer. The following appears in the court's opinion at p. 809:

> "The situation would appear to be governed by rule 15(b) providing that *when issues not raised by the pleadings are tried by express or implied consent of the parties, they are to be treated in all respects as if they had been formally raised.* Compare Balabanoff v. Kellogg, 9 Cir., 118 F.2d 597; Rogers v. Union Pac. R. Co., 9 Cir. 145 F.2d 119. It is plain that the experienced judge who presided at the trial regarded the issue of contributory negligence as having been brought into the case by implied consent and consequently felt obliged to instruct in respect of it." (Emphasis supplied)

In *Glens Falls Indemnity Company* v. *United States* the court said at p. 375:

> *"The issue of failure of performance of conditions precedent was not specifically raised by the pleadings or urged at the trial below.* Considering the nature of the case and the multiple issues framed and litigated by the parties, the findings and con-

> clusions fully determined every substantial question of fact and law presented. *The question of performance by Radkovich was completely litigated. Issues actually tried are deemed raised in the pleadings.* Federal Rules of Civil Procedure, Rule 15(b)." (Emphasis supplied)

The issues upon which Findings of Fact 4, 6 and 8, to which the appellant has made reference, and Finding 3, which was integrally related to Finding 4, are based, were fully developed by testimony introduced without objection by the appellant—indeed in part by the appellant himself. The various so-called option documents were specifically set forth in the Pre-Trial Order. The nature of the transaction between the parties, the obligations of the bankrupt to repay the sum advanced, together with interest, the participation of the bankrupt in profits, and related matters considered by the Court, were all the subject of specific testimony by the appellant.

Since the issues upon which the Findings of Fact and Conclusions of Law were based were fully tried, the court was called upon to make findings thereon. 3 Moore Federal Practice, 2d Ed. 996 where the following appears:

> "It should be noted that Rule 15(b) is not permissive in terms: it provides that issues tried by express or implied consent *shall* be treated as if raised in the pleadings. In a court case, the court must make findings on such issues."

And see *Securities and Exchange Commission* v.

Rapp, 2 Cir., 304 F.2d 786 (1962) in which the court said at p. 790:

> "In the district court Judge Murphy gave judgment for defendants dismissing the complaint. The principal ground of decision appears to have been that the pleadings did not conform to the proof; he denied a motion, made at the close of argument, to amend the pleadings so to conform. This ruling was clearly in error. F. R. 15(b) provides that '[w]hen issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings.' *This is mandatory, not merely permissive.*" (Emphasis supplied)

It is submitted, therefore, that the appellant's argument in support of his third specification of error must necessary fail.

4. Argument for Affirmance of Judgment

The judgment of the trial court must be affirmed in the absence of a showing by appellant that the trial court's Findings of Fact are clearly erroneous. Rule 52a, F.R. Civ. P., 28 U.S.C.; *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.,* 8 Cir., 199 F.2d 511 (1952); and *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.,* 9 Cir., 292 F.2d 640 (1961).

Rule 52a, F.R. Civ. P., 28 U.S.C. provides in part

> "Findings of Fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

In *Fireside Marshmallow Co.* v. *Frank Quinlan Const. Co.* the following appears at p. 514:

> "Under the well recognized rule that the findings of fact of a trial court may not be set aside unless clearly erroneous, we examine the evidence in the light most favorable to the finding and *if there be substantive evidence to support it, we may not set it aside.*" (Emphasis supplied)

In *American Pipe & Steel Corp.* v. *Firestone Tire & Rubber Co.* the following appears at p. 644:

> "Both the finding of no further damage, and that an 'equitable adjustment' of all damage had been made, are findings of fact, not subject to review or change by this appellate court unless clearly erroneous (Fed. R. Civ. P. 51, 28 USCA). On the record before us, particularly, we cannot come to any such conclusion as a matter of law."

It is submitted that the appellant has not shown that the trial court's findings were clearly erroneous. On the contrary, as has been shown by the appellee, there is an abundance of evidence in support of the court's findings.

With respect to the credibility of the witnesses, it is submitted that this may well have been a factor. There was a conflict in the testimony of the appellant (Tr. 43, 110) and that of the Honorable Estes Snedecor, Referee in Bankruptcy (Tr. 84), as to what transpired following the taking of the defendant's testimony before the Referee on June 11, 1964, and the assertion of claims by the trustee under the March 4, 1964, agreement. There was a conflict in the testimony of the appellant

(Tr. 29-30, 79, 113) and that of Mr. Zanley Galton (Tr. 79, 98-99, 101) relative to negotiations with respect to the sale of the corporation and the price thereof.

It would further appear that the trial court, from its frequent inquiries (Tr. 31, 66-67, 72, 80-1, 98), was skeptical concerning the appellant's testimony relative to the value placed by him on the franchise (Tr. 64-66, 79), that a price of $10,000 for the franchise was requested by him of Mr. Galton and particularly that an offer of $25,000 therefor was made by Moncrief-Lenoir without any mention or suggestion of that amount by the appellant (Tr. 31, 64, 78).

CONCLUSION

It is respectfully submitted therefore that the Findings of Fact and Conclusions of Law are amply supported by the evidence, that the appellant has failed to show that they are clearly erroneous and that the judgment in favor of the appellee should be affirmed.

Respectfully submitted,

GILBERT SUSSMAN
SUSSMAN, SHANK & WAPNICK
Attorneys for Appellee

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

GILBERT SUSSMAN
SUSSMAN, SHANK & WAPNICK
Attorneys for Appellee

No. 20567

United States
COURT OF APPEALS
for the Ninth Circuit

ALONZO W. DERING,

Appellant,

v.

EVERETTE H. WILLIAMS, Trustee in Bankruptcy of Eldon P. Dering, bankrupt,

Appellee.

APPELLANT'S REPLY BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE WILLIAM T. BEEKS, Judge

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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 1-66

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REPLY TO APPELLEE'S STATEMENT OF FACTS

Appellee's Statement of Fact does not seriously controvert the Statement of Facts in Appellant's opening brief, but is incomplete and argumentative. Appellant believes it needs no reply.

SUMMARY OF REPLY ARGUMENT

1. Specification of Error No. 1

a) The four option documents dated December 6, 1961 to February 20, 1963, inclusive, as well as the agreement dated March 4, 1964 were what they purport to be.

b) The finding that such transactions were security devices is not supported by the evidence.

2. Specification of Error No. 2

The agreement of March 4, 1964 cannot be both a valid agreement and an invalid one.

If it is invalid as a transfer in fraud of creditors, when set aside, it reinstated previous agreements and the option of September 30, 1951 was in force and was exercised by appellant. If it was a security device, the option of September 30, 1951 was in effect. If it is valid, then appellee's rights were limited to the agreement. The District Court held that appellee was not entitled to recover under it because it had not been assumed by him (R. 49).

3. Specification of Error No. 3

The inconsistency of appellee's position is clearly evidenced by the assertions:

a) That the agreement of March 4, 1964 is invalid because it was a transfer without consideration and in fraud of creditors (Appellee Br. 21, 27, 28), and

b) That the same agreement of March 4, 1964 was valid, provided for cancellation of previous agreements and was "an agreement for sale or liquidation of the corporation" (Appellee Br. 9, 20).

Both statements cannot be correct. Analysis shows that the agreement was not in fraud of creditors. It was valid, but recovery was denied by the District Court on the ground that the trustee did not assume it.

REPLY TO ANSWER TO FIRST SPECIFICATION OF ERROR

Appellee asserts that appellant overlooked evidence in analyzing the option agreements, and the error committed by the Court in holding them to be security devices, but fails to point out any evidence not included by appellant.

Appellee also claims that the agreement of March 4, 1964 is not a security device within the purview of Finding No. 4 of the District Court (R. 88, Appellee Br. 12).

To avoid repetition, the appellant will reply to this contention in his Reply to the Answer to the Third Specification of Error.

Appellee cites *Umpqua Forest Industries* v. *Neenah Ore Land Co.* (1950) 188 Or. 605 at 633, 217 P.2d 219 at 230 (Appelle Br. 17), to the point that the debtor's pressing need for money puts him at the mercy of the creditor, which is a circumstance to "be considered as tending to show the intention to create a mortgage."

Appellant has no quarrel with this statement, but the evidence in the instant case does not show a "pressing need for money" at the time of the option of December 16, 1961, which fixed the character or status of the agreements (Tr. 14). Also, the transactions did not involve the insistent creditor, as transferee and optionor, which is the usual situation where a conveyance and option is claimed to be a security device.

Finding No. 4 holding these agreements to be security devices is inconsistent with the theory upon which appellee tried this case, and also is not supported by the facts. Amendments to the Pre-Trial Order will not be considered when the facts are insufficient.

REPLY TO ANSWER TO SECOND SPECIFICATION OF ERROR

Appellee challenges the timeliness of the exercise of the option of September 30, 1951 by appellant to purchase any stock interest in Dearing Industries, Inc., owned by the bankrupt or the trustee, as his successor.

A complete answer to this challenge is that the right to purchase under the option only became absolute upon bankrupt's adjudication, and it was exercised within a reasonable time thereafter.

Appellee also asserts that this option of September 30, 1951 was no longer in existence after the execution of the agreement of March 4, 1964 because it was cancelled by the latter agreement (Appellee Br. 20, 21). This claim that the agreement of March 4, 1964 was valid involves the same question as is raised in the

Answer to the First Specification of Error—the legal effect of the agreement of March 4, 1964. This will be fully covered by the Reply to the Answer to the Third Specification of Error.

REPLY TO ANSWER TO THIRD SPECIFICATION OF ERROR

Appellee asserts that the agreement of March 4, 1964 was within one year of bankruptcy and in fraud of creditors in that it released the equity of the bankrupt in the corporate stock of Dering Industries, Inc., without consideration except cancellation of indebtedness; that, therefore, the agreement is void and must be set aside.

This agreement was the only transaction between the parties within one year of bankruptcy. The District Court held that such a fraudulent transaction had occurred (Finding No. 6, R. 88), but was unable to identify the date of the transaction (R. 51). The appellee, in his attempt to sustain Finding No. 6, must pin the label on the agreement of March 4, 1964.

The entire agreement is as follows:

> "AGREEMENT—BETWEEN ALONZO W. DERING—ELDON P. DERING.
>
> "This agreement cancels the option dated February 20th, 1963 and signed by Alonzo W. Dering. This option was given to Eldon P. Dering for the purchase from Alonzo W. Dering of one hundred (100) shares of capital stock of Dering Industries, Inc. The purchase price for the purchase of such shares was to be the sum of ten thousand dollars

($10,000.00) plus accumulated interest at six percent (6%) from June 1, 1963 until date of purchase.

"This agreement is beingexecuted (sic) for the purpose of selling Dering Industries, Inc., or in the event that a sale is not made; to liquidate Dering Industries, Inc. This sale or liquidation to be started this date and be completed or in the process of completion by May 31st, 1964.

"It is agreed between Alonzo W. Dering and Eldon P. Dering that this agreement will be effective and neither party to this agreement can stop the proceedings once started.

"The proceeds from this sale or liquidation are to be divided as follows:

(1) Alonzo W. Dering is to receive one hundred dollars $100.00) per share for each share or capital stock of Dering Industries, Inc., held in his name at date of sale or liquidation.

(2) Eldon P. Dering agrees to purchase one hundred (100) shares of capital stock of Dering Industries, Inc., from Alonzo W. Dering for ten thousand dollars— ($10,000.00) plus accumulated interest at six percent (6%) from June 1, 1963 to date of purchase. Date of purchase to be prior to date of sale or liquidation.

(3) Eldon P. Dering is to receive one hundred dollars ($100.00) per share for each share of capital stock of Dering Industries, Inc., held in his name at date of sale or liquidation.

(4) The profits from the sale or liquidation of Dering Industries, Inc., are to be divided equally.

"The intent of this agreement is to return twenty thousand dollars ($20,000) invested in Dering Industries, Inc., by Alonzo W. Dering as of this date plus interest at six percent (6%) on ten thousand dollars ($10,000.00) from June 1, 1963 until date of purchase of one hundred shares (100) of capital stock of Dering Industries, Inc., by Eldon P. Dering. This sale of stock by Alonzo W. Dering to Eldon P. Dering would make an investment of ten thousand dollars ($10,000.00) each by Alonzo W. Dering and Eldon P. Dering. The excess of over twenty thousand dollars—($20,00.00) to be equally divided between Alonzo W. Dering and Eldon P. Dering.

"This agreement, and all the terms thereof, is personal to Eldon P. Dering and Alonzo W. Dering and may not be sold, assigned, transferred or alienated, voluntarily or involuntary.

"Dated: March 4th, 1964."

The correct construction of this agreement is the most important point in this appeal.

1. Appellant contends the District Court committed error when the agreement, and the previous options, were held to be security devices. (First Specification of Error)

In answer, appellee says that this agreement is outside the scope of Finding No. 4 concerning security devices (R. 88).

2. Appellant contends that the District Court committed error when it refused to give effect to the option of September 30, 1951. (Second Specification of Error)

In answer, appellee says that this agreement of March 4, 1964 was valid and superseded all previous options which were held by the District Court to be security devices, and cancelled the option of September 30, 1951.

3. Appellant contends that the District Court found that there was a fraudulent transfer within one year of bankruptcy when there was no evidence of any such transfer. (Third Specification of Error)

In answer, appellee asserts that the agreement of March 4, 1964 was a fraudulent transfer and therefore voidable—although the District Court was unable to identify the transaction by date.

There are three possible constructions that can be put upon this agreement:

a) That it was a contract or option to buy and sell stock;

b) That it was a security device;

c) That it was a transfer in fraud of creditors.

Contract or Option to Buy and Sell Stock

This is the theory both parties adopted in the trial in the District Court. Appellant urged recovery should be denied because the trustee had not assumed the executory contract within the period of time allowed by

statute. Appellee asserted that adequate notice of assumption had been given, and that the provisions of the contract requiring concurrent performance by the bankrupt and the appellant were void as unenforceable (Contention No. 4, Pre-Trial Order, R. 38).

The District Court held that the appellee had not assumed the contract within the time required and therefore could not recover under its terms (R. 49).

Now appellee contends that this contract was valid to the extent that, by its terms, it superseded and cancelled all previous option agreements; that its provisions concerning the concurrent conditions are unenforceable (Appellee Br. 20, 21, 25, 26); appellee also contends that it was a transaction in fraud of creditors without fair consideration and must be set aside (Appellee Br. 21, 27, 28).

Appellant's position is that this agreement, as well as all previous agreements, was what it purported to be, and assigned as his First Specification of Error the holding by the District Court that these transactions were security devices.

Security Device

Appellee asserts that the agreement of March 4, 1964 was not held by the District Court to be a security transaction, claiming that Finding No. 4, which reads as follows:

> " '4. The various transactions involving the delivery and transfer of sums from defendant to bankrupt and from bankrupt to defendant and

> the execution and delivery of the aforementioned options superseded each other and said option documents were intended to constitute security devices for loans made by the defendant to the bankrupt.' (R. 88 Findings etc.)"

does not include the agreement of March 4, 1964 (Appellee Br. 13).

It is submitted the appellee's interpretation of Finding No. 4 is entirely too strict, since the finding includes transactions where no funds passed between the parties.

If the agreement of March 4, 1964 is not within the scope of Finding No. 4, there is no finding covering that transaction; it will be shown not to be a transfer in fraud of creditors; the District Court committed error in finding that the transaction was a security device, but having so found, committed additional error by not giving effect to the option agreement of September 30, 1951. This is the Second Specification of Error.

Transaction in Fraud of Creditors

In its Memorandum Opinion, the District Court found that there had been a transaction within one year of bankruptcy, otherwise unidentified, which was voidable because the only consideration therefor was the cancellation of indebtedness (Findings 6, 8; R. 88, 89).

Consideration for Agreement

Appellee asserts that the cancellation of the previous agreements ". . . was its sole objective *except for the apportionment of the proceeds.*" (Emphasis added) (Appellee Br. 24).

Since appellee admits that under the terms of the agreement, if bankrupt or appellee had assumed the contract and performed, certain moneys would have been payable to the bankrupt or the appellee, his successor in interest, the contention that the only consideration received by the bankrupt was the cancellation of an indebtedness must fail.

Appellee argues that the provision that the bankrupt was, by its terms, required to pay for such stock before May 31, 1963, and as a concurrent condition to its acquisition, was impossible of performance, would constitute a forfeiture and therefore was unenforceable.

If the provision as to concurrency of performance were held void, that would not destroy the consideration. However, the condition was not impossible of performance.

Whether insolvent or not, the owner of a contract right can borrow money upon it. If this right of the bankrupt was valued at $25,000, it would seem that $10,600 could have been borrowed against it.

There would have been some risk attached because Moncrief-Lenore might not have performed its executory contract. Appellee's plan apparently was to lay

back, let the appellant bear any risk of loss or litigation, and then, if everything went well, attempt to share the benefits. But if the benefits are to be shared, the risk must be shared. This the bankrupt and appellee were unwilling to do. In any event, appellant submits this question is moot, because the District Court found appellee had not assumed the contract (R. 49).

As additional consideration, however, the bankrupt was given approximately 85 days within which to exercise his rights under this agreement, whereas under the previous agreement he had only 15 days after demand within which to perform (R. 22, 23). This period of time extended well beyond the date of the trustee's appointment. Failure of the trustee to assume the agreement and perform does not destroy the consideration therefor or make the agreement in fraud of creditors.

Considering the foregoing, appellant submits that the Third Specification of Error, i.e., that there was no evidence of a transaction in fraud of creditors, must be sustained, since the evidence shows that this was not a transaction in fraud of creditors and admittedly was the only transaction between the parties within the year.

Effect of Avoidance of Agreement

It is submitted that if the transaction of March 4, 1964 is to be set aside, as being in fraud of creditors, then it must be set aside in its entirety. 11 U.S.C. 110 (e), Sec. 70(e) Bank. Act.

Apparently it is the appellee's position that the

transaction of March 4, 1964 is good and valid insofar as it cancels previous agreements, but still must be set aside as being in fraud of creditors:

> "The March 4, 1964, agreement specifically provides for the cancellation of the so-called option document of February 20, 1963. In view of the court's finding that the February 20, 1963 option document was a security device, it necessarily follows that the consideration which the bankrupt received for the sale of his equitable interest in the 100 shares of stock, worth $25,120 was simply a cancellation of his indebtedness of $10,600 . . ." (Appellee Br. 27-28)

Appellee does not explain how the agreement of March 4, 1964 can be set aside as a transaction in fraud of creditors, without reinstating the previous agreements, including the option of September 30, 1951.

The reverse is also true—if the agreement of March 4, 1964 was effective to cancel the previous agreements and as an apportionment of the proceeds, if the bankrupt, or the trustee as his successor, had performed, then it is not a transfer in fraud of creditors. Relief to appellee under this theory was denied because he did not assume the executory contract (R. 49).

CONCLUSION

1. The first question for decision is the status of the options of December 6, 1961; June 6, 1962; December 6, 1962 and February 20, 1963:

a) If these documents are what they purport to be,

bankrupt had no interest, legal or equitable, in any stock of Dering Industries, Inc.

b) If these documents were security devices, bankrupt had an equitable interest in stock in Dering Industries, Inc., subject to the option in favor of appellant dated September 30, 1951 which was exercised.

2. The second question for decision is the character of the agreement of March 4, 1964;

a) If the agreement of March 4, 1964 was what it purported to be, appellee had no right to recover because the District Court held appellee had not assumed the contract.

b) If the agreement of March 4, 1964 was a security device, appellant's rights under the option of September 30, 1951 continued and were exercised.

c) If the agreement of March 4, 1964 was voidable as a transfer without fair consideration, in fraud of creditors, it must be set aside in its entirety, the previous agreements reinstated and the rights of the parties determined in the light of the previous transactions.

In any event, the judgment in favor of appellee must be reversed. Whether or not appellee is entitled to recover a smaller sum from appellant depends upon this Court's decision on the "security device" question.

Respectfully submitted,

C. X. Bollenback
Attorney for Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

C. X. Bollenback

IN THE

UNITED STATES COURT OF APPEALS FOR

THE NINTH CIRCUIT

JOHN G. GROVES, Trustee, Appellant, vs. FRESNO GUARANTEE SAVINGS AND LOAN ASSOCIATION, Appellee,	NO. 20,581

APPELLANT'S OPENING BRIEF

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Attorneys for Appellant

IN THE

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JURISDICTIONAL STATEMENT

Notice of appeal was filed with the District Court on November 4, 1965 (R 39). * Appeal is taken from the Order of the District Court entered on October 5, 1965 (R. 36).

The United States Court of Appeals for the Ninth Circuit is vested with jurisdiction of this appeal from a final Order of the United States District Court for the Southern District of California, Northern Division, by Judicial Code Sections 1291 & 1294(2),, 28 U.S.C. Sections 1291 & 1294(2), and Bankruptcy Act Sections 24a & 25a, 11 U.S.C. Sections 47a & 48a.

No written notice of entry of judgment was served upon Appellant. The Order appealed from involves a sum in excess of $40,000.00 (R. 35).

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* Citations to the Record on Appeal throughout Appellant's briefs are in the above form, which indicates the page in the (Clerk's) Transcript of Record. There is no reporter's transcript.

STATEMENT OF THE CASE

This appeal involves proceedings originally commenced by a partnership named, "Park Terrace," which filed a petition for an arrangement under Chapter XI of the Bankruptcy Act on September 30, 1964. The partnership was appointed debtor-in-possession of its properties, which included an apartment building known as "Park Terrace Apartments" (R. 20).

On October 2, 1964, the partnership, debtor-in-possession, filed a petition for an order to show cause re nature and validity of the lien claimed by Appellee to the rents of the Park Terrace Apartments (R. 2-4; R. 19). On March 16, 1965, the Referee in Bankruptcy filed his Findings of Fact, Conclusions of Law, and Judgment, which determined the issues raised by the Petition filed on October 2, 1964 (R. 19-25, Findings, etc.).

Previous to the entry of the Referee's Judgment on January 26, 1965, the partnership was adjudicated a bankrupt and Appellant was appointed trustee of the bankrupt's estate (R. 22; R. 18).

Appellant, being aggrieved by the Referee's Judgment petitioned the District Court for review (R. 27-8, Petition for Review), on March 26, 1965. The review proceeding was determined adversely to Appellant by an Order of the Honorable M. D. Crocker, District Judge, entered on November 5, 1965, (R. 36-8, Order Affirming Referee's Order).

The issue before the referee, on review, and on this appeal is whether Appellee had taken, before bankruptcy proceedings began, the steps required to perfect a pledge of rentals made in a deed of trust

held by Appellee ("Respondent's Exhibit 'E' "). This issue was tried to the Referee in Bankruptcy on October 16, 1964 (R. 19).

Parenthetically, it must be noted that Appellee has collected all of the rentals falling due after the bankruptcy (Chapter XI) proceedings were commenced on September 30, 1964. The Referee's Order to Show Cause (R. 6-8) restrained Appellee from "any act or proceeding in the enforcement of its lien or liens on the property" (R. 7). This portion of the Referee's Order was modified on ex-parte application by the Honorable M. D. Crocker, District Judge, sitting as a Judge of the Bankruptcy Court, on October 5, 1964 (R. 16-17). Pursuant to Judge Crocker's modification, Appellee has collected all rental income from the apartment building during the course of the proceedings.

The fair market value of the apartment building was $760,000.00 (R. 21). Appellee's deed of trust secured a principal balance of $592,326.53. The total liens upon the apartment building were in the sum of $651,000.00 (R. 21). Appellant, therefore, had an equity in the real property of $109,000.00.

The only facts to support the rulings of the Referee and the District Court, i.e., that the assignment of rents was perfected before the Bankruptcy Court obtained jurisdiction over the apartment building, are contained in Finding VIII of the Referee. This finding, in its entirety, is as follows:

> "That Petitioner (Appellant) is in default in payments of principal and interest due under the first deed of trust note in favor of Respondent (Appellee). That Respondent (Appellee) did on September 25, 1964, cause notice of the default to be recorded in the Official Records of Fresno, County, California, and did, prior to the filing of debtor's Petition herein, serve on tenants of the Park Terrace Apartments a notice to the effect that Respondent (Appellee) was exercising its right under said deed of trust to collect the rents falling due from the tenants thereafter and that said tenants should pay all such rents to Respondent (Appellee) accordingly." (R. 22).

The Referee's First Conclusion of Law was "That debtor herein (the partnership) was on September 30, 1964, at the time of the filing of the Petition herein, in possession of the premises" (R. 23). The supporting finding is finding VI, that the partnership had a managing agent residing at the apartment building on September 30, 1965, and thereafter (R. 21-22).

The Referee's Second Conclusion of Law is the one challenged by Appellant. It reads as follows:

> "That Respondent, Fresno Guarantee Savings & Loan Association, did take action prior to September 30, 1964, to commence enforcement of the assignment of rents clause contained in the deed of trust described hereinabove. That by virtue thereof, said Respondent (Appellee) is entitled to the rents from said premises." (R. 23).

SPECIFICATIONS OF ERROR

(1) The Findings of Fact of the Referee in Bankruptcy, which were adopted by the District Court, do not support the Judgment and Conclusions of the Referee, which were adopted by the District Court.

(2) The District Court, in approving the decision of the Referee, erred in concluding that the assignment of rents was valid and enforceable as against the representative of the bankruptcy estate.

(3) The District Court erred in failing to sustain Appellant's objections set forth in the Petition for Review, filed on March 26, 1965.

INTRODUCTION AND SUMMARY OF ARGUMENT

Appellee failed to move for sequestration of rents of the Park Terrace Apartments. Appellee never obtained possession in accord with its deed of trust. Appellee never sought a receiver in the California Courts. Appellee never demanded possession of the Park Terrace Apartments. Appellee did not prove a deficiency or that its security was inadequate. In sum, Appellee never perfected a right to rentals of the apartment house.

The Park Terrace partnership exercised a lawful right when it petitioned the District Court for relief under Chapter XI of the Bankruptcy Act on September 30, 1964. Appellee had commenced non-judicial foreclosure and had served notice on tenants (but not the owners) that they should make payments to Appellee (R. 22). The partnership owned an interest worth $109,000.00 more than all liens on the apartment house, including the debt secured by Appellee's trust deed. Admitedly, the partnership was in default on its obligation. Appellee's security, however, was worth more than $167,000.00 in excess of the debt owed it (R. 21).

The question presented to this court is, simply, whether Appellee obtained a valid lien in the rentals before the Bankruptcy Court acquired exclusive jurisdiction over the property on September 30, 1964. Before the District Court, Appellee argued that equitable considerations supported the ruling of the Referee. Those arguments are far wide of the issue for two main reasons: (1) the issue is one of California real property security law only, and (2) sequestration of the rents would have been denied on the equitable ground that Appellee's security was of far greater value than the amount of indebtedness.

ARGUMENT

I. THE RULINGS OF THE DISTRICT JUDGE AND THE REFEREE IN BANKRUPTCY ARE INCONSISTENT WITH CALIFORNIA LAW.

Federal courts, exercising their bankruptcy jurisdiction, are required to apply local, State law on questions of title to and security in real property. E.g., Victor Gruen Associates, Inc. v Glass, 338 F.2d 826, 829 (9th Cir. 1964); Judicial Code Section 1652, 28 U.S.C. Section 1652. Whether federal equity rules are additionally applicable is treated later in this brief, Section II, B. Since the federal court and the subject real property were situate in California, its law governs. The controlling decision is Malsman v. Brandler, 230 Cal. App. 2d 922, 41 Cal. Rptr. 438 (1964). This decision is not novel, it simply is an application of the law announced by the California Supreme Court in Childs Real Estate Co. v. Shelbourne Realty Co., 23 Cal. 2d 263, 143 P. 2d 697 (1943), and Kinnison v. Guaranty Liquidating Corp., 18 Cal. 2 256, 115 P. 2d 540 (1941).

There can be no serious doubt that the case at bench falls squarely within the holding of Malsman v. Brandler, 230 Cal. App. 2d 922, 41 Cal. Rptr. 438 (1964), supra. The facts and the security instrument in the Malsman case and those in the instant case are compared in the two following pages.

Malsman vs. Brandler
230 Cal. App. 2d 922, 41 Cal. Rptr. 438 (1964)

December 1, 1961:	Trustors defaulted.
January 1, 1962:	Demand made for rents.
March 27, 1962:	Suit filed; receiver appointed.

Possession: Beneficiary under trust deed did not have possession until March 27, 1962.

RENTS CLAUSE

"That as additional security, Trustor hereby gives to and confers upon Beneficiary the right, power and authority, ... to collect the rents, issues and profits of said property, reserving unto Trustor the right, prior to any default by Trustor in payment of any indebtedness secured hereby ... to collect and retain such rents, issues and profits as they become due and payable. Upon any such default, Beneficiary may at any time without notice, either in person, by agent, or by a receiver to be appointed by a court,... enter upon and take possession of said property ... in his own name sue for or otherwise collect such rents, issues and profits ... and apply the same, ... upon any indebtedness secured hereby ... The entering upon and taking possession of said property, the collection of such rents, issues and profits ... shall not cure or waive any default hereunder ...."

Held on appeal: The trustors "were entitled to retain the rents collected before the beneficiary took possession by the appointment of a receiver." 230 Cal. App. 2d at 924, 41 Cal. Rptr. at 441.

THIS APPEAL

Groves vs. Fresno Guarantee Svgs. & Loan Assn.

September 25, 1964: Notice of Default recorded.
September 30, 1964: Notice served on tenants.
September 30, 1964: Bankruptcy Court obtained exclusive jurisdiction.

Possession: Beneficiary under trust deed did not have possession on September 30, 1964.

RENTS CLAUSE

"As additional security, Trustor hereby gives to and confers upon Beneficiary the right, power, and authority, ... to collect the rents, issues, and profits of said property, reserving unto Trustor the right prior to any default in payment of any indebtedness secured hereby ... to collect and retain such rents, issues, and profits as they become due and payable. Upon any such default, Beneficiary may at any time without notice, either in person, by agent, or by a receiver to be appointed by a court, ... enter upon and take possession of said property ..., in its own name sue for or otherwise collect such rents, issues, and profits, ... and apply the same ... upon any indebtedness secured hereby .... The entering upon and taking possession of said property, the collection of such rents, issues, and profits, and the application thereof as aforesaid, shall not cure or waive any default hereunder....."

Held below: That prior to September 30, 1964, beneficiary took actions "to commence enforcement of the assignment of rents clause .... that by virtue thereof (beneficiary) is entitled to the rents from said premises." Conclusion II (R. 23).

In the Order appealed from, the District Judge ruled that Appellee "had taken all possible affirmative steps to perfect its right to the rents" (R. 38). This statement is badly inaccurate. California lawyers are well aware that an assignee of rents must either obtain possession or appointment of a receiver to secure a right to rents and issues of mortgaged real property, when the assignment of rents clause is written as was the one under review. The best teachers of this requirement are the Malsman case and the two California Supreme Court decisions upon which it is based.

Notice to tenants that they should pay rent to Appellee (R. 22, Finding VII), was without consequence. The assignment of rents clause in Appellee's trust deed does not require, support, or prescribe any notice to tenants. The California cases on the issue do not place any legal effect on such notices. Certainly notice to tenants must not be given any greater legal consequence than the court gave the demand for rents on January 1, 1962, in Malsman v. Brandler, supra. For a decision that notice to tenants is not equivalent to possession, see In re Sweeney, 212 Fed. 1 (3rd Cir. 1914). *

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* "(W)e are advised of no statute or decision supporting the proposition that the mere notice of an asserted right to collect the rents is equivalent to possession." 212 Fed. at 3.

II. APPELLEE IS NOT ENTITLED TO THE RENTS AS A MATTER OF EQUITY.

A. The Order Below was Inequitable and Unjust.

In its brief to the District Court, on review of the referee's judgment, Appellee argued that equity supported its claim to the rents. This contention distorts the reality and record in the present case. The apartment house was worth more than $167,000.00 in excess of Appellee's secured debt (R. 21). Enforcement of the assignment of rents clause in Appellee's trust deed simply and effectively choked the last breath from the debtor in the Chapter XI proceedings.

Because Judge Crocker, by the modification of October 5, 1964 (R. 16-17), allowed Appellee all of the rents, the partnership was eventually adjudicated a bankrupt before the validity of Appellee's lien in the rents could be litigated (R. 22). This was manifestly inequitable and unnecessary in light of the excess value to Appellee's security. The general creditors (whose claims are reflected in the Claims Register which was brought up with the Record on Appeal) could never be induced to consent to any proposal of a debtor with no income, and a plan of arrangement became inconceivable.

To prove an equitable claim to rents, a mortgagee must show "that the mortgaged property was worth less than the mortgage indebtedness." In re Cigar Stores Realty Holdings, Inc., 69 F. 2d 823 (2nd Cir. 1934).

One of the significant equitable considerations in this matter is the brute fact that Appellee never moved to sequester the rents. In a similar case, where the mortgagee failed to seek

sequestration, Judge Learned Hand held "the mortgagee must apply to have the rents sequestered in his favor ... they are general assets (of the bankruptcy estate) as long as he does nothing." In re Humeston, 83 F. 2d 187, 188 (2nd Cir. 1936); see also Nash v. Onondaga Hotel Corporation, 140 F. 2d 209, 211 (2nd Cir. 1944).

Appellant readily admits that the statutes and decisions governing perfection of liens by secured creditors are sometimes technical and demanding. These laws, however, embody the underlying philosophy of creditor's rights and insolvency proceedings. The writer knows of no case where a lien void against a creditor of the debtor-bankrupt has been upheld as against a trustee in bankruptcy because of an equitable recognition that the secured creditor could have perfected his lien by some course of action he failed to take. In this case the Appellee could have perfected its lien by appointment of a receiver or by taking possession. It did neither.

On the present facts, the cardinal equity is the interest of the unsecured creditors for whom Appellant is trustee. The referee destroyed the unsecured creditors' opportunity for pecuniary return by the order granting Appellant all rents. Judge Crocker's modification of the temporary order destroyed the hope for an arrangement by denying the debtor any income. The consequence of these orders was that the unsecured creditors lost the income from rents, which went to the Appellant, who already had security of a value $167,000.00 in excess of its claim.

B. Equity Doctrines Must not be Applied to Enlarge or Restrict State-created Rights In Real Property.

A question separate and distinct from the particular equities in this case, is whether any equitable principles apply to

Appellee's rents clause, other than equitable doctrines that might apply as a matter of California real property law. The authors of IV Collier on Bankruptcy 1054-1056, ¶ 70.16 (14th ed. 1964), raise this separate issue by their observation that the results in some lower federal courts have been,

> "that federal equitable principles have been allowed to alter the dictates of state law as to the effect of the mortgage transaction. Whether this is now permissible in light of Erie Railroad Company v. Tompkins (304 U.S. 64 (1938)) is a debatable issue." Ibid., at 1055-6.

The Supreme Court of the United States has not resolved this debate. For a general discussion of the Erie issue in a wide variety of bankruptcy contexts, see Hill, "The Erie Doctrine in Bankruptcy," 66 Harv. L. Rev. 1013 (1953), cited in Collier, supra.

Appellant submits that state law is supreme on all questions of title to and security in real property. E. g., Victor Gruen Associates, Inc. v. Glass, 338 F.2d 826, 829 (9th Cir. 1964). The substantive law, as distinguished from that which governs administration of a bankruptcy estate, is State law. Rules of Decision Act, as amended, 28 U.S.C. Section 1652, as construed in Erie R. Co. v. Tompkins, 304 U.S. 64 (1938).

Appellant does not suggest or contend that the Erie case stripped from bankruptcy courts their equity powers. In a number of post-Erie decisions the Supreme Court has approved or required use of equity powers by bankruptcy courts. Some examples are: (1) where a fiduciary has sought personal advantage, Pepper v. Litton, 308 U.S. 307 (1939), (2) where a parent organization or person is denied equal distribution with other claimants, Consolidated Rock Products Co. v.

participate with persons in the class to which his guaranty extended, American Surety Co. v. Sampsell, 327 U.S. 269 (1946), and (4) where a controlling person has mismanaged the bankrupt's estate, Taylor v. Standard Gas & Electric Co., 306 U.S. 307 (1939).

But these decisions were instances of use of equity power to prevent inequitable distributions from bankruptcy estates. See Hill, supra, 66 Harv. L. Rev., at 1020-1024. In the present case, Appellee would have this court wield equity power, in conflict with controlling State law, to achieve a patently unjust distribution of the bankrupt's assets.

The Supreme Court has spoken directly, in a post-Erie case, to the present issue. The Court held that real property rights are determined under State law. Thompson v. Magnolia Petroleum Co., 309 U.S. 478, 483-484 (1940), which held that Illinois courts should decide a question of fee simple ownership of a right of way. The Court said,

> "Unless the matter is referred to the State courts, upon subsequent decision by the Supreme Court of Illinois it may appear that rights in local property of parties to this proceeding have - by the accident of federal jurisdiction - been determined contrary to the law of the state which in such matters is supreme." 309 U.S. at 484.

C. The Decision of the Ninth Circuit in Pollack v. Sampsell does Not Require that Appellee's Trust Deed be Given Effect Different from the Effect it is Accorded by California Law.

Before the District Court, in the review proceedings, Appellee strenuously urged application of the equitable principles

discussed at length in Pollack v. Sampsell, 174 F. 2d 415 (9th Cir. 1949). That case upheld the claim of a real property mortgagee to the proceeds of a crop harvested after bankruptcy was commenced by the mortgagor. In a scholarly treatment of the equities between the contesting parties in that matter, the court examined many of the bankruptcy precedents in the Ninth and other Circuits.

The court in Pollack v. Sampsell did not deal with the Erie doctrine because the court reached a conclusion fully consistent with State law. The court did observe, however, that the Ninth Circuit had declined to go so far as had the Seventh and Third Circuits in providing greater rights for the mortgagee "notwithstanding the contingent character of his lien" under State law. 174 F. 2d at 418, 2nd col.

The determinative feature and basis of Pollack v. Sampsell, and the reason that decision does not control the instant appeal is that the result reached in Pollack v. Sampsell was also the result required by State law. See 174 F. 2d at 421, n. 4, where the court held:

> "Under the California decisions to the effect that unharvested crops are a part of the realty, Wilson v. White, 161 Cal. 453, 460, 119 P. 895, the same result would have followed in this case even if the trust deeds had made no mention of the rents, issues or profits."

The equities of the instant case and Pollack v. Sampsell, are diametrically opposite in a crucial respect. In the Pollack case the bankruptcy court permitted foreclosure under state law to proceed, and a foreclosure sale resulted. On appeal, the parties conceded that the foreclosure sale by the mortgagee "resulted in a deficiency in excess of the amount for which the crop had been sold." 174 F. 2d at 417, 1st col. But in the present case the security was worth $167,000.00 more than the amount of the mortgagee's (Appellee's) secured balance.

Furthermore, in Pollack v. Sampsell, supra, the mortgagee had not failed to pursue his state law remedies. That mortgagee sought equitable relief from the bankruptcy court because his security, an orange crop, actually matured after bankruptcy proceedings had commenced. In the present case, the mortgagee could have, but failed to, perfect its security interest in the rents before the bankruptcy petition was filed. Moreover, the mortgagee in Pollack v. Sampsell, sought relief from the bankruptcy court on the ground "that the land was of insufficient value to pay the secured indebtedness," 174 F. 2d at 417, which obviously was not true in the instant case.

In sum, Appellant submits that no equitable consideration in this case supports the orders of the District Court and referee in bankruptcy. Appellant also submits that the controlling rule of decision is the law of California, which requires reversal of the judgment below. Finally, Appellee cannot apply the federal equity rules to this appeal, because it never invoked the equity power of the bankruptcy court by moving to sequester. See, e.g., In re Humeston, 83 F. 2d 187, 188 (2nd Cir. 1936), supra.

III. ASSUMING APPELLEE HAD MOVED TO SEQUESTER, ITS CLAIM TO THE RENTS WOULD PROPERLY HAVE BEEN DENIED.

Had Appellee moved for sequestration, its motion would have been denied. The federal decisions are unequivocal in requiring that the mortgage security be shown inadequate before the mortgagee will be given the rents. But, before developing this point, Appellant must observe that the sequestration precedents are the very cases that Appellee argues establish its equitable right to rents.

Assuming, arguendo, that Erie R. Co. v. Tompkins does not foreclose the equity contention, that contention falls of its own weight. The sequestration cases are those which define and delimit the equitable principles and powers of the bankruptcy court. Assuming, further, that Appellee had invoked these powers by a petition to sequester, that body of bankruptcy law would have dictated denial of the rents. Thus, Appellee's entire equity argument falls with application of the rules for sequestration of rents. No one argues that the instant case is governed by any equitable principles above or beyond those expressed in the sequestration decisions.

A decision directly in point is In re Cigar Stores Realty Holdings, Inc., 69 F. 2d 823 (2nd Cir. 1934). The court denied sequestration, holding, "In any event, a condition precedent to the right of the mortgagee to rents collected is proof of a deficiency." 69 F. 2d at 823. In that case, fee title to the mortgaged property had been sold by the trustee in bankruptcy for a sum of $50.00 in excess of all liens, and the court simply denied the mortgagee's claim to rents collected by the trustee, on the ground that the mortgagee

did not show "that the mortgaged property was worth less than the mortgage indebtedness." 69 F. 2d at 823. Appellee has not proven a deficiency. In the Cigar Stores case, supra, the bankrupt's interest was worth $50.00. In the present case it was worth over $109,000.00 (R. 21).

Appellee's failure to sequester the rents may have been motivated by its mistaken belief that it had a valid lien in the rents, or by the correct belief that sequestration would be denied because the security was more than adequate. Whatever its reason, Appellee is now barred from claiming the rents, for the universal rule is that the rents subject to sequestration are those which fall due after the mortgagee's application or petition to the bankruptcy court. See, e.g., Investors Syndicate v. Smith, 105 F. 2d 611, 621-622 (9th Cir. 1939), In re Humeston, 83 F. 2d 187 (2nd Cir. 1936).

Moreover, a mortgagee who is entitled to rents on his application to sequester is entitled only to the net rentals, after payment of costs of administration of the bankruptcy estate and taxes. E.g., Florida Nat. Bank of Jacksonville v. United States, 87 F. 2d 896 (5th Cir. 1937). If Appellee prevailed in the present proceeding, it would receive the gross rentals before payment of administration expenses.

Finally, this court has previously held that failure to sequester is fatal, where the lien to rents and issues was not perfected prior to commencement of bankruptcy. In re Hotel St. James Co., 65 F. 2d 82 (9th Cir. 1933), following In re Brose, 254 Fed. 664 (2nd Cir. 1918).

CONCLUSION

Appellee did not comply with California law. The pledge of rents was never perfected as a valid security interest. Appellant's claim to the rents is of superior equity. Sequestration of the rents would have been denied. Sequestration, which is never retrospective, was not sought by Appellee.

Appellant, therefore, respectfully submits that the judgment below should be reversed and the cause remanded to the referee in bankruptcy.

Respectfully submitted,

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By_____

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JOHN G. GROVES, Trustee

ATTORNEY'S CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated and executed this _____ day of February, 1966.

William T. Richert

WILLIAM T. RICHERT

No. 20,581

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN G. GROVES, Trustee,
Appellant,

vs.

FRESNO GUARANTEE SAVINGS AND LOAN ASSOCIATION,
Appellee.

On Appeal from the United States District Court for the Southern District of California, Northern Division

BRIEF FOR APPELLEE

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No. 20,581

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN G. GROVES, Trustee, *Appellant,* vs. FRESNO GUARANTEE SAVINGS AND LOAN ASSOCIATION, *Appellee.*	

On Appeal from the United States District Court for the Southern District of California, Northern Division

BRIEF FOR APPELLEE

JURISDICTIONAL STATEMENT

The appeal in this case is from an order of the United States District Court for the Southern District of California, Northern Division, made in proceedings in bankruptcy. This Court has jurisdiction under Section 24a of the Bankruptcy Act (11 U.S.C. § 47a).

STATEMENT OF THE CASE

Park Terrace, a partnership, on September 30, 1964 filed a debtor's petition for an arrangement under Chapter XI of the Bankruptcy Act (R. 20). The

The judgment entered on the Referee's findings and conclusions enjoined appellee from commencing or continuing with proceedings to enforce the lien of its deed of trust until the further order of the court (R. 23-25), but decreed that:

> "pending the further order of this Court respondent shall continue as heretofore to manage and operate said property and to collect the rentals becoming due from the tenants of said property and respondent shall be responsible for the proper maintenance and operation of the premises comprising said property and shall be accountable to this Court for all rentals heretofore as well as hereafter collected by respondent from said tenants." (R. 24.)

Appellant petitioned the District Court for review of the Referee's order with respect to the rents (R. 27-28). The Honorable M. D. Crocker, United States District Judge, affirmed the Referee's order (R. 36-38) and the present appeal ensued.

QUESTION PRESENTED

Whether, by virtue of appellee's rights under its trust deed and actions taken by appellee before and after the bankruptcy proceedings began, appellee was entitled to retain the rents it had collected up to the time of the bankruptcy court's decision and to continue collecting the rents of the mortgaged property until the further order of the court, with the right to apply them as provided in the trust deed, subject to accountability for them to the court.

ARGUMENT

SUMMARY

The bankruptcy court's ruling that appellee was entitled under its trust deed to the rents of the mortgaged property, subject to accountability for them to the court, was in no way at odds with California law. The California cases hold that an assignment-of-rents clause in a trust deed is not self-executing on the trustor's default, and the beneficiary must do something more than make a demand on the trustor for the rents to perfect a claim to them. Appellee had started non-judicial foreclosure proceedings, had notified the tenants of the property to pay their rents to appellee, had taken over the actual operation of the property—and may be said to have had *de facto* possession of it, and was actually collecting the rents and holding them when the bankruptcy court made its ruling.

The order appealed from is in accord with prior decisions of this Court, in particular *Pollack v. Sampsell* (9th Cir. 1949) 174 F.2d 415. Appellee was assiduously pursuing its rights as beneficiary of the defaulted trust deed when the bankruptcy court's jurisdiction intervened, and persistently asserted its rights to the rents throughout the proceedings in bankruptcy.

There was no occasion for appellee to apply for a separate order sequestering the rents. Appellee itself was actually collecting and holding the rents. The court's orders with respect to the rents were in practical and legal effect sequestration orders.

On the face of the Referee's findings, appellant and the unsecured creditors he represents stood to lose nothing by the order appealed from. By its express terms appellee is accountable to the court for all the rents in question. Appellee claims only the right to apply the rents as provided in the trust deed, i.e., to costs of operating and maintaining the property while the rents were being collected and to the secured debt. If the property was worth more than the amount of the secured debt, the bankruptcy estate would necessarily receive the full benefit of the rents in the final accounting, which has yet to be made.

I. THE BANKRUPTCY COURT'S DECISION THAT APPELLEE WAS ENTITLED TO COLLECT AND RETAIN THE RENTS OF THE MORTGAGED PROPERTY, SUBJECT TO ACCOUNTABILITY FOR THEM TO THE COURT, WAS IN NO WAY INCONSISTENT WITH CALIFORNIA LAW.

We agree with appellant that federal courts of bankruptcy must apply state law in determining property rights, including rights under a trust deed. Appellant's concern on the point is ironical, however, considering that appellant's predecessor in interest, the debtor-bankrupt, invoked the jurisdiction and processes of the bankruptcy court with the object of preventing appellee from exercising rights which appellee had according to state law (see debtor's Petition for Order to Show Cause, etc., R. 2-4).

According to the California cases cited by appellant, *Childs Real Estate Co. v. Shelbourne Realty Co.* (1943) 23 Cal.2d 263, 143 P.2d 697, *Kinnison v. Guar-*

anty Liquidating Corp. (1941) 18 Cal.2d 256, 115 P. 2d 450, and *Malsman v. Brandler* (1964) 230 Cal.App. 2d 922, 41 Cal.Rptr. 438, the general rule is that a mortgagee[1] is not entitled to the rents of the mortgaged property until he obtains possession of it or has a receiver appointed. That this rule is subject to exceptions, however, is illustrated by *Title Guarantee & Trust Co. v. Monson* (1938) 11 Cal.2d 621, 627, 81 P.2d 944, where it was held that a beneficiary of a trust deed similar in its terms to the trust deed in the present case, who had demanded and was refused possession of the property after default, was entitled to the rents from the date he demanded possession. And to the same effect is *Mortgage Guaranty Co. v. Sampsell* (1942) 51 Cal.App.2d 180, 189-190, 124 P.2d 353.

Appellant insists that *Malsman v. Brandler* (1964) 230 Cal.App.2d 922, 41 Cal.Rptr. 438, *supra,* is controlling in the present case. There it was held that a trust deed essentially the same in its language as appellee's trust deed was not self-executing as an assignment of rents on default, and that the trustors were entitled to keep the rents they collected from the property up to the date the beneficiaries filed an action for appointment of a receiver. The similarity between *Malsman* and the present case begins and ends with the similarity of language in the trust deeds. In *Malsman* the beneficiaries merely notified the trustors

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[1]California follows the lien theory of mortgages and makes no distinction which is pertinent here between mortgages and trust deeds. West's Annotated California Codes, Civil Code § 2888. Therefore in this brief we will use the terms "mortgage" and "trust deed" and related terms interchangeably.

of the latters' default and demanded that any rents collected be delivered over, and did nothing further until they filed an action against the trustors, during which time the trustors continued to collect the rents. In the present case, the beneficiary—appellee—caused notice of default to be recorded in the official records of the county (R. 22); notified the tenants of the property that it was exercising its rights under the trust deed to collect the rents and that the tenants should make their rental payments accordingly (R. 22); and proceeded actually to collect the rents and in fact collected and now holds all the rents which are in dispute.

Moreover, although the Referee concluded as a matter of law that the debtor, and not appellee, was in possession of the property (R. 23),[2] it can reasonably be inferred from the record as a whole that appellee had *de facto* possession of the property at all times while the rents in dispute were being collected. This is indicated by the provision in the court's order of October 5, 1964 which provided that appellee might "continue collecting rentals becoming due from tenants of said premises" and would "be responsible for the proper maintenance and operation of said premises," (R. 17) and the terms of the order appealed from which provided that appellee should "continue as heretofore to manage and operate said

[2]This conclusion was based on a finding that the managing partner of the debtor partnership resided in one of the apartments on the property on and after September 30, 1964 and "was at all such times the agent of the partnership, overseeing the management of the said apartments" (R. 21-22).

property and to collect the rentals becoming due from the tenants of said property" and would "be responsible for the proper maintenance and operation of the premises comprising said property" (R. 24).

II. THE BANKRUPTCY COURT'S DECISION ON THE RENTS QUESTION WAS IN ACCORD WITH PRIOR DECISIONS OF THIS COURT.

The Court of Appeals for the Ninth Circuit has decided a number of the leading cases on the question of a mortgagee's rights to rents, issues and profits of the mortgaged property after default where bankruptcy of the mortgagor has intervened. Among them are *Pollack v. Sampsell* (1949) 174 F.2d 415; *Investors Syndicate v. Smith* (1939) 105 F.2d 611; *American Trust Co. v. England* (1936) 84 F.2d 352; and *In re Hotel St. James Co.* (1933) 65 F.2d 82. These and the other bankruptcy case authorities in point are collected in 4 Collier on Bankruptcy, 14th Edition, ¶ 70.16 [7], at pages 1044 to 1056.

In *American Trust Co. v. England, supra,* it was held that a petition by the mortgagee for sequestration of the rents, followed by a sequestration order, was the equivalent of taking possession of the mortgaged property by the mortgagee, with the effect that the mortgagee was held entitled to the rents from the time of filing the petition for sequestration.

Pollack v. Sampsell, supra, 174 F.2d 415, is particularly close to the present case in principle and on its facts. It concerned the rights of a beneficiary of Cali-

fornia trust deeds to the proceeds of a crop harvested from the mortgaged lands by the trustee in bankruptcy of the trustors. The beneficiary had started non-judicial foreclosure proceedings before the bankruptcy filing, and was prevented from going forward with the foreclosure by a restraining order of the bankruptcy court. The crop matured and was harvested and sold while the restraining order was in effect, and the net proceeds of the sale were impounded under an arrangement the beneficiary made with the trustee in bankruptcy, pending the court's determination of the beneficiary's rights thereto. The bankruptcy court eventually ruled that the beneficiary had no interest in the crop or its proceeds. In the meantime the beneficiary had been permitted to proceed with non-judicial foreclosure and a trustee's sale of the lands had ensued, resulting in a deficiency. On appeal, this Court reversed the bankruptcy court's decision, holding that the beneficiary was entitled to the proceeds of the crop by virtue of his rights under the trust deeds and the diligence he had exercised in pursuit of those rights. The court stated the applicable rule as follows:

> "[W]here the holder of the trust deed or mortgage has either by appropriate steps taken prior to bankruptcy, or by timely application to the bankruptcy court, actively undertaken to obtain the rents or profits of the real property for application upon the mortgage indebtedness, it is then the duty of the bankruptcy court to preserve the rents and profits for the holder of the trust deed or mortgage. These decisions [referring generally to decisions so holding] may be justified upon

the ground that in such cases the diligence of the mortgagee has demonstrated that he would probably have realized upon the rents or profits had bankruptcy not intervened." 174 F.2d at 419.

Another leading case in point is *Mortgage Loan Co. v. Livingston* (8th Cir. 1930) 45 F.2d 28. Judge Pope speaking for this Court in *Pollack v. Sampsell, supra,* 174 F.2d 415, said:

"The facts of this case are very similar to those in *Mortgage Loan Co. v. Livington,* 8 Cir., 45 F. 2d 28. In that case the controversy concerned the rents and issues of hotel property operated by a receiver in bankruptcy proceedings brought against the mortgagor of the hotel property. After default under the mortgage, the mortgagee initiated foreclosure by advertisement, and sale under power of sale was to have been held on June 29. A few days prior to that date, the petition in bankruptcy was filed and the court appointed a receiver and entered an order enjoining the foreclosure sale. The mortgagees asserted claim to the rents and issues collected by the receiver following the date when the mortgagees' sale was first advertised to be held. Subsequently the court granted leave to sell the property under the mortgage, and at the sale a deficiency was disclosed. The mortgage there described the real estate 'together with all * * * rents, issues and profits thereto belonging,' and provided that the trustee under the mortgage should be entitled to possession of the property directly or through a receiver in the event of default, and recited that he should have a right in that event to collect the revenue therefrom. When the foreclosure was restrained and the receiver appointed, counsel for

the mortgagees by letter advised the bankruptcy receiver of their claim to the rents and profits and requested the receiver to segregate the revenues from the hotel and to apply them to the payment of existing defaults under the mortgage. The receiver agreed that the hotel revenues should be kept separately but the mortgagees' petition for an order directing the receiver to pay them the revenues collected from the hotel for application upon the deficiency under the foreclosure sale, which exceeded that amount, was denied by the court except to the extent of the taxes and insurance on the property, the court holding that the mortgagees were not entitled to the rents and profits in question.

"Upon appeal the court held the mortgagees should have these rents. In an opinion the language of which we might well adopt here, the court said, 45 F. 2d at pages 32, 34: 'We are of the view that the mortgagees in effect intervened in the receivership proceedings in aid of their proceedings to foreclose, and this intervention operated to charge all of the net income arising from the operation of the property by the receiver with the lien of their mortgage. * * *

" 'To hold that the mortgagees had a legal right to these rents and issues under the provisions of their mortgage, but that they should be precluded from recovering same because they had not technically pursued a legal remedy is to overlook the fact that the property was in the control of a court of equity, and that equitable remedies commensurate with the legal rights of the parties should be available. To take from the mortgagees the property to which confessedly

they are entitled under the pledge provision of their mortgage, and transfer it to the unsecured creditors of the bankrupt, appeals to us as harsh, inequitable, and unwarranted.' " 174 F.2d 419-421.

III. THE BANKRUPTCY COURT CORRECTLY APPLIED EQUITABLE PRINCIPLES IN DECIDING THE CASE.

In answering appellant's argument that "the order below was inequitable and unjust," we cannot let stand without challenge the following assertions made in appellant's brief:

> "* * * Enforcement of the assignment of rents clause in Appellee's trust deed simply and effectively choked the last breath from the debtor in the Chapter XI proceedings.
>
> "Because Judge Crocker, by the modification of October 5, 1964 (R. 16-17), allowed Appellee all of the rents, the partnership was eventually adjudicated a bankrupt before the validity of Appellee's lien and the rents could be litigated (R. 22). This was manifestly inequitable and unnecessary in light of the excess value to Appellee's security. The general creditors (whose claims are reflected in the Claims Register which was brought up with the Record on Appeal) could never be induced to consent to any proposal of a debtor with no income, and a plan of arrangement became inconceivable." (Appellant's Opening Brief 11.)
>
> "* * * The Referee destroyed the unsecured creditors' opportunity for pecuniary return by the order granting Appellant all rents. Judge Crocker's modification of the temporary order

> destroyed the hope for an arrangement by denying the debtor any income." (Appellant's Opening Brief 12.)

These assertions are a gross distortion of the facts and are not supported by anything in the record. Moreover they are irrelevant; they are obviously spoken not by or for appellant, the trustee in bankruptcy, but by the ghost of the bankrupt partnership.

Appellant asserts that "to prove an equitable claim to rents, a mortgagee must show 'that the mortgaged property was worth less than the mortgage indebtedness,'" citing *In re Cigar Stores Realty Holdings, Inc.* (2d Cir. 1934) 69 F.2d 823 (Appellant's Opening Brief 11). The facts of the *Cigar Stores* case, however, were that the mortgagee there took no action and made no claim until after the trustee had sold the bankruptcy estate's equity in the property; then the mortgagee, without having even started a foreclosure proceeding, demanded that the trustee turn over the rents which he had collected from the property before making the sale. In holding that the mortgagee was not entitled to the rents the court said:

> "In any event, a condition precedent to the right of a mortgagee to rents collected is proof of a deficiency. * * * There is none here. And a mortgagee must account for rents received. * * * The fact that the property was sold for $50 in excess of all liens and charges of every nature indicates no deficiency and so no right to retain rents anyway on an accounting." (69 F.2d at 823.)

In contrast, the mortgagee in the present case—appellee—actively asserted its right to receive the rents

before the bankruptcy court issued its initial restraining order, continuously asserted that right throughout the bankruptcy proceedings, and actually collected and is holding the rents which are in issue. The mention in the *Cigar Stores* case of a mortgagee's duty to account for rents he receives from the mortgaged property has special significance for our case. Appellee has recognized from the beginning that it is accountable for the rents it has collected, and the order appealed from expressly makes appellee accountable to the court for those rents (R. 24). The "proof of deficiency," if there is a deficiency, will be presented when appellee makes its accounting.

We do not take issue with appellant's argument that federal as opposed to state equity doctrines should not be applied so as to alter state-created property rights. Appellee's case does not require us to do so. Nevertheless it is still true that bankruptcy proceedings are equitable in nature "and within the limits prescribed by the Bankruptcy Act and the special rules of practice prescribed by the Supreme Court are to be administered in accord with the general principles and practices of equity." *Pepper v. Litton* (1939) 308 U.S. 295, 303-308, 60 S.Ct. 238. It was therefore proper for the bankruptcy court to observe fundamental rules of equity in deciding the case.

The question of who should collect and hold the rents was presented to the bankruptcy court not as an independent question but in conjunction with the question whether the foreclosure proceedings appellee had commenced should be stayed. Appellee vigorously

contested the stay, contending that the fair market value of the property was less than the amount of the secured debt and the stay would only cause appellee further financial loss (Supplemental Record, Respondent's Answer to Petition for Order to Show Cause). The Referee was called upon to balance the equities between appellee and the unsecured creditors. On the one hand, a stay of enforcement of appellee's lien was desirable from the unsecured creditors' standpoint so that appellant, the trustee in bankruptcy, should have a fair opportunity to liquidate the bankruptcy estate's equity in the property. On the other hand, if the property proved to be worth less than the amount of the secured debt owed to appellee, the stay would be at the expense and risk of appellee. The unsecured creditors had everything to gain and nothing to lose by the stay, but the opposite was true of appellee. Appellee was then operating the property and collecting the rents by authority of the modified restraining order. By allowing appellee to remain in charge and to collect the rents, with the right to apply the net rents to the secured debt, subject to accountability to the court, the risk of loss to appellee by reason of the stay would be mitigated in some degree at least; and if the property proved to be worth more than the amount of the secured debt owed to appellee, it would make no difference to the unsecured creditors that appellee had received the rents, since every dollar of net rents applied to the secured debt would add another dollar to the value of the bankruptcy estate's equity in the property.

So the decision of the Referee staying the foreclosure proceedings but allowing appellee to collect the rents was an equitable one, made with due regard for the legitimate interests of both sides. A contrary decision, staying the foreclosure proceedings and denying appellee the rents, would have loaded the scales inequitably against appellee.

IV. THE EFFECT OF THE BANKRUPTCY COURT'S ORDERS WAS THE SAME AS IF A SPECIFIC SEQUESTRATION ORDER HAD BEEN MADE.

Appellant refers to the "brute fact" that appellee never moved to sequester the rents, and argues that this omission was fatal to appellee's case, citing *In re Humeston* (2d Cir. 1936) 83 F.2d 187, 188, and *Nash v. Onandaga Hotel Corp.* (2d Cir. 1944) 140 F.2d 209, 211 (Appellant's Opening Brief 11-12). In each of those cases the mortgagee had taken no affirmative step to claim the rents until after they were collected by the trustee or debtor, and then claimed them on the theory that the mortgage lien had somehow attached to them. In contrast, the mortgagees in *Pollack v. Sampsell* (9th Cir. 1949) 174 F.2d 415, and *Mortgage Loan Co. v. Livingston* (8th Cir. 1930) 45 F.2d 28, as in the present case, vigorously asserted their rights under the mortgage instrument both before and after the property came under the bankruptcy court's jurisdiction and ultimately prevailed although they made no application for a sequestration order.

Although insisting that appellee had no right to the rents because it did not move for a sequestration order (Appellant's Opening Brief 11-12, 16, 18), appellant argues that appellee would not have been entitled to a sequestration order anyway, because according to the Referee's findings the security for appellee's debt was more than adequate (Id. 17-18). The only authority cited for this proposition is *In re Cigar Stores Realty Holdings, Inc.* (2d Cir. 1934) 69 F.2d 823, a case we have already discussed,[3] where the mortgagee did nothing whatsoever until after the rents had been collected by the trustees in bankruptcy and did not at any time apply for a sequestration order. The case cannot by any stretch of imagination be read as holding or even suggesting that the mortgagee of property of a bankruptcy estate will not be entitled to an order sequestering the rents of the property unless he shows that the property is worth less than the mortgage indebtedness. What the opinion in the case does suggest is that where the rents of the mortgaged property have been sequestered, the mortgagee will be entitled to them only to the extent he can prove a deficiency. No more than this is claimed for appellee with respect to the rents which appellee has collected and for which it is accountable in the present case.

Appellant's contention that if the rents had been sequestered they would be available for payment of bankrupt administration expenses is not supported by any clear authority and will not stand up under

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[3]See page 14, *supra*.

analysis. The legal effect of sequestration is to make the rents subject to the lien of the mortgage. See *In re Kings County Real Estate Corp.* (2d Cir. 1933) 67 F.2d 895, 896. If sequestered, how could the rents be used for paying bankruptcy administration expenses, any more than the mortgaged property itself could be liquidated and used for this purpose?

Although not labeled as sequestration orders, the two orders (R. 17 and 24) which the bankruptcy court made with respect to the rents were in practical effect sequestration orders. Appellee was allowed to collect the rents until the further order of the court and was made accountable to the court for them, and their ultimate disposition was by clear implication left for later determination by the court (Ibid.). The rents were just as effectively sequestered as if the term "sequestration" had been used. There is no prescribed language or form for sequestration orders. Therefore there is no reason from the standpoint of either substance or form why the rent orders in question cannot be treated for all intents and purposes as sequestration orders.

V. ON THE FACE OF THE REFEREE'S FINDINGS, THE BANKRUPTCY ESTATE STOOD TO LOSE NOTHING BY THE ORDER APPEALED FROM, AND APPELLANT HAS NOT SHOWN THAT THE ESTATE ACTUALLY LOST ANYTHING BY THAT ORDER.

Nowhere in appellant's argument is any recognition given to the fact that by the express terms of the order appealed from appellee is accountable to the court for all the rents in dispute.[4] Appellee has never claimed to be entitled absolutely to these rents. On the contrary, appellee claims only the right to apply them as provided in the trust deed (R.—Respondent's Exhibit E), i.e., to costs and expenses incurred in maintaining and operating the property while the rents were being collected, and to the secured debt. Both the modified restraining order (R. 17) and the order appealed from (R. 24) charged appellee with responsibility for the "proper maintenance and operation of the premises comprising said property." In the ultimate accounting appellee should be allowed credit for reasonable and necessary expenditures made in discharging that responsibility. *Clayton v. Schultz* (1941) 18 Cal.2d 328, 334, 115 P.2d 446. In any event, the determination of whether appellee has fully accounted for the rents and has properly applied them

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[4]Appellant at one stage seems to have overlooked this fact completely. In his notice of appeal (R. 39) it is stated that he "appeals . . . from that part only of the order . . . denying the bankrupt's petition for an order that respondent account for all rentals collected by it on property of the bankrupt." There was such a petition by the bankrupt, and appellee (respondent below) made an accounting in response to it, but the proceeding was dismissed on motion of appellant after the adjudication of bankruptcy (R.—Docket Entries, page 2, entries 1/8/65, 1/25/65 and 2/4/65, and page 3, entries 2/24/65).

will be made by the bankruptcy court, and appellant will have full opportunity to be heard in that proceeding.

Obviously it is the *net* rents, after appellee is allowed proper credit for reasonable and necessary expenditures made in maintaining and operating the property, which are at stake in this appeal. The essence of the bankruptcy court's decision which appellant is challenging is that the net rents should be available to be applied to the secured debt owed to appellee. But how, we ask, was appellant conceivably hurt by this decision if, as appellant's argument repeatedly stresses, the mortgaged property had a value of $167,000 greater than the amount of the secured debt owed to appellee, and the bankruptcy estate's equity in the property was worth $109,000? (see Appellant's Opening Brief 3, 6, 11, 12, 15 and 18). If the Referee's finding as to the value of the property is taken as conclusive, as appellant's argument apparently insists it must be, then the court may well wonder what this appeal is all about. Every dollar of the rents applied to the secured debt would add another dollar to the value of the estate's equity in the property. The practical result in terms of net asset values added to the estate would be the same as if appellant himself had received the rents.

As trustee in bankruptcy appellant has the duty to liquidate the assets of the estate with all reasonable dispatch. Bankruptcy Act Section 47a (1) (11 U.S.C. § 74). The bankruptcy court's order staying the enforcement of appellee's lien—made in conjunction with

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APPELLANT'S CLOSING BRIEF

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RESTATEMENT OF THE CASE

Appellee's Statement of the Case is in error. The only facts before this court on appeal and the only facts that were before the District Court on review are those found and set forth by the Referee (Findings, R. 20-22). Neither Appellee nor Appellant have ever challenged these Findings, and thus no Reporter's Transcript was ever prepared or filed on review or appeal.

At page 2 of its Brief, Appellee asserts that by October 2, 1964 it "had assumed practically full charge of the operation of the premises and was collecting the rents (R. 36-37)." The portion of the Record on Appeal cited for this assertion is the District Court's Memorandum Order, for which there is no support in the Findings. As a matter of fact, the Finding on the subject (VIII, R. 22) recites: "That no rents were collected either by the debtor after the filing of the notice of default by respondent and prior to the filing of the petition in bankruptcy herein, and that no rent became due during said period."

Appellee bases part of its argument, e.g. page 7 of its Brief, on the existence of a demand for possession. The facts are: (1) the partnership, debtor-bankrupt, was the trustor by a deed of trust to Appellee (Exhibit E), (2) the partnership was represented at the premises of the apartment building by its managing partner, one John Azlant. (Finding VI, R. 21-22), and (3) Appellee never made any demand whatever on the trustor partnership for possession of the

apartment house. The Findings of Fact are absolutely silent on the question of such demand, and the Findings negate any implication that demand was so made prior to 4:26 o'clock p.m., September 30, 1964, or thereafter.

Finally, Appellee must be credited with a correct statement of the fair market value of the apartment building - $760,000.00 - and a correct statement of the sum secured by its deed of trust - $592,000.00. Obviously, the Appellee had a margin of safety or excess value to its security in the approximate amount of $167,000.00.

QUESTION PRESENTED

Appellee has side-stepped the issue. The Appellee's Reply Brief fails to develop a clash with the Opening Brief, and it fails to assist the court to understand the basic controversy. The question presented to this court is, simply, whether Appellee obtained a valid lien in the rentals before the Bankruptcy Court acquired exclusive jurisdiction over the property on September 30, 1964.

Appellee would have court and counsel believe that the issue is whether it could collect the rents and continue collecting them after the decision below, "subject to accountability for them." See "Question Presented," Appellee's Brief, p. 4. Appellee ignores reality in assuming that the question of its "accountability" could be determined without resolution by this court of the issue of the validity of Appellee's lien in the rentals, collected and held by Appellee.

The focal point of the question presented is the Referee's Conclusion of Law II,

> "That respondent, Fresno Guarantee Savings & Loan Association, did take action prior to September 30, 1964 to commence enforcement of the assignment of rents clause contained in the deed of trust described hereinabove. That by virtue thereof, said respondent is entitled to the rents from said premises."

Appellant contends this conclusion was erroneous.

ARGUMENT

A. INTRODUCTION

The best explanation of Appellee's failure to meet the issue is that the Referee erred in concluding that the assignment of rents was effective. The comparison made in the Opening Brief, pp. 8-9, of the facts here and in Malsman v. Brandler, 230 Cal. App. 2d 922, 41 Cal. Rptr. 439 (1964), leaves no doubt that Appellee's assignment of rents was not perfected under California law before September 30, 1964.

Appellee has divided its Reply Brief into five arguments. These five arguments will be answered in part B. hereof, "Rebuttal", giving the same sub-numbers to the corresponding portions of Appellee's Reply Brief.

B. REBUTTAL

I. THE BANKRUPTCY COURT'S DECISION WAS INCONSISTENT WITH CALIFORNIA LAW.

The argument, which appears in Appellee's Reply Brief, pp. 6-9, boils down to the assertion: "it can reasonably be inferred from the record as a whole that appellee had de facto possession of the property at all times while the rents in dispute were being collected." Id., p. 8. The quoted statement is not only

presumptuous, it is misleading. It presumes that this court may draw an inference in conflict with the express, unchallenged Findings of Fact. It tends to mislead the court to the view that possession after September 30, 1964 is material to the disputed issue. The Findings establish that no rents were collected until after September 30, 1964, and it is therefore obvious that Appellee was arguing about de facto possession after that all-important date when the petition in bankruptcy was filed.

Appellee has also restated the rule that a demand for possession entitles the mortgagee to pledged rentals, citing Title Guarantee & Trust Co. v. Monson, 11 Cal. 2d, 621, 81 p. 2d 944 (1938), and Mortgage Guaranty Co. v. Sampsell, 51 Cal App. 2d 180, 124 P. 2d 180, 124 P. 2d 353 (1942). This is the law of California, but it is not applicable to the case at bench, since Appellee never so demanded possession.

This rule serves, however, to illustrate how Appellee dramatically failed to perfect its security. If Appellee had made such a demand upon the partnership before September 30, 1964, Appellee would have legally obtained the rents. Throughout its Brief, Appellee urges that it actively asserted its right to receive the rents, but as a matter of fact Appellee failed to take the easiest, most elementary step - it failed to demand of the partnership possession of the apartment house.

Again, in its attempt to distinguish Malsman v. Brandler, supra (Appelee's Brief, pp. 7-8), Appellee has ignored the significant

date when the petition was filed. Its argument that it collected rents pursuant to an ex parte order pendente lite is probative of nothing, especially when the collections were made after the last date Appellee could have perfected its security. Moreover, one of the lessons of the Malsman case itself is that a demand for rents is not effective.

II. THE BANKRUPTCY COURT'S DECISION IS NOT SUPPORTED BY PRIOR RULINGS OF THIS COURT.

The corresponding section of Appellee's brief is mainly an extensive quotation from Judge Pope's scholarly opinion for this court in Pollack v. Sampsell, 174 F. 2d 415 (9th Cir. 1949). There are two distinct and unrelated reasons why this court's opinion in the Pollack case does not support the decision below: (1) in Pollack v. Sampsell the mortgagee had established that there was a deficiency due on its claim, 174 F. 2d at 417, and (2) in Pollack v. Sampsell the court was not faced with the objection that its decision was contrary to State law and therefore in conflict with Erie R. Co. v. Tompkins, 304 U.S. 64 (1938).

Pollack v. Sampsell involved a real property mortgage, and the controversy was over proceeds of a crop grown on the pledged real property. It was proven that there was a "deficiency in excess of the amount for which the crop had been sold." 174 F. 2d at 417. For this reason, standing alone, the Pollack case has no application to the present appeal, where the real property apart

from its rents and issues was of a value $167,000.00 in excess of the secured balance due Appellee. The significance of this fact is underscored by Appellee's ex parte Petition, presented to Honorable M. D. Crocker, District Judge, on October 5, 1964.

This Petition was made part of the Record on Appeal as a supplemental record. At page 4 of that Petition, the present Appellee made the following representation to the Bankruptcy Court:

> "7. Petitioner is informed and believes, and therefore alleges, that the fair market value of said premises does not exceed the total indebtedness of debtor to petitioner which is secured by said deed of trust . . . . "

Of course, upon the trial of the Order to Show Cause, this representation was proven false, as were many other representations in the same Petition. The point of mentioning this at all is that Appellee itself recognizes that an essential basis for its claim to the rents was that it would otherwise be left with a deficiency.

The second reason Pollack v. Sampsell does not control is that the result there reached was that required by State law. See 174 F. 2d at 421, N. 4, and Opening Brief, p. 15. The unharvested crops were by virtue of state law charged with the lien of the mortgagee of the land. Therefore, the question of the Erie doctrine in bankruptcy was not reached by the court. Appellee has chosen to completely ignore the application of Erie R. Co. v. Tompkins to its reliance upon the language in Pollack v. Sampsell. Again, Appellee seeks to avoid the issue. By reason of this failure of Appellee to brief

the Erie question, Appellant will not here reiterate the original discussion in the Opening Brief, pp. 12-14.

It must, however, be observed that the equitable principles discussed in Pollack, in IV Collier on Bankruptcy 1044-1056 (14th ed. 1964), and throughout Appellee's Reply Brief should be applied only when they do not generate consequences different from those which obtain under State law. If these doctrines are ever to be applied (contrary to their application in Pollack) to accord a mortgagee greater security than he would have under State law, they should be invoked by the bankruptcy court to alleviate a deficiency, not to grant a windfall. See In re Cigar Stores Realty Holdings, Inc., 69 F. 2d 823 (2nd Cir. 1934).

III. THE BANKRUPTCY COURT DID NOT CORRECTLY APPLY EQUITABLE PRINCIPLES

Appellee, presumably with tongue in cheek, asserts that the Opening Brief spoke for "the ghost of the bankrupt partnership." Reply Brief, P. 14. The remark belies Appellee's labored effort to avoid the issue, namely, whether its assignment of rents was perfected before bankruptcy. The issue would be the same if the partnership had filed a petition for liquidation, "straight bankruptcy", rather than for an arrangement.

Special equities, however, do arise because the partnership-debtor was proceeding under Chapter XI. That is, until the proposed plan of arrangement could be confirmed or found not feasible, and in the event of confirmation, it was essential to debtor that it have operating income. In light of the court's finding that the apartment house was worth $167,000.00 more than the amount due Appellee, what equitable principle commands the bankruptcy court to destroy a plan of arrangement by denying the debtor any income from the apartment building? Appellee has cited no authority for such a principle of equity.

The Appellee's argument at pages 15-17 of its Brief is based upon an extreme distortion of the issue presented by this appeal. That argument contends that a stay of foreclosure was equitable only when the court gave the rents to Appellee. No authority is cited for this contention, which has no support in logic. The perfection of the

pledge made of rents in the trust deed has no connection with the propriety of staying foreclosure proceedings. If foreclosure had not been stayed, the court would still have the same question before it, namely, whether Appellee was entitled to rents collected before the foreclosure sale.

The Bankruptcy Court did not correctly apply the equitable principles, since there was no deficiency owing to Appellee. Appellee has not filed a deficiency claim (see certified copy of Claims Register, sent up with Record on Appeal), and the Findings (R. 21) contradict any conceivable inference there was a deficiency. The proof of a deficiency made in Pollack v. Sampsell, supra, has already been cited. 174 F2d at 417. Moreover, the prime authority cited by Appellee, Mortgage Loan Co. v. Livingston, 45 F. 2d 28 (8th Cir. 1930), was a case where the mortgages had proved their deficiency was the sum of $35,000.00. 45 F.2d at 31.

IV. THE ORDER BELOW WAS NOT A SEQUESTRATION ORDER.

Appellee would have this court overlook the pleadings which framed the issues in the trial court. The initial pleading was the partnership's Petition for Order to Show Cause (R. 11-12), filed on October 2, 1964. The reply was Appellee's Answer to Petition for Order to Show Cause (a part of the Supplemental Record on Appeal), filed on October 14, 1964. The petition prayed for an order that Appellee show cause why the Bankruptcy Court "should not determine the nature, extent and validity of" Appellee's lien (R. 12).

The Answer of Appellee set up the following matters in defense: (1) that the deed of trust contained the assignment of rents clause quoted in the Opening Brief, p. 8, (2) that Appellee had been, on September 25, 1964 and thereafter, in "exclusive possession of said property," and (3) that the debtor's equity in the property was then worthless. The Answer set up no equitable defenses and did not seek sequestration of the rents. Moreover, the Answer was an implicit admission that Appellee was flagrantly in contempt of court by its violation of the restraining order set forth on page two, lines 10-18 of the Order to Show Cause (R. 7), until the Order Modifying Temporary Restraining Order (R. 16) was signed by Judge Crocker on October 5, 1964.

In any event, the Appellee has never sought sequestration of the rents. It has only relied on the perfection of its

assignment of rents clause, as far as the record reflects its attempts to obtain the rents by lawful means.

At page 17 of its Reply Brief, Appellee declares that the mortgagees in Pollack v. Sampsell, 174 F.2d 415 (9th Cir. 1949), and Mortgage Loan Co. v. Livingston, 45 F.2d 28 (8th Cir. 1930), made no application for a sequestration order. In the Livingston opinion the court stated that the mortgagee made such an application on October 24, 1927. 45 F.2d at 30, 2nd col. In the Pollack case, such application was unnecessary because the real property mortgagee had a perfected, valid, and prior lien in the unharvested orange crop at the date the bankruptcy petition was filed. 174 F.2d at 419, 2nd. col. And, of course, in both cases the mortgagees had established undisputed deficiencies.

Appellee concedes that it is entitled to the rents only to the extent it can prove a deficiency. See Reply Brief, p. 18. This is a rather large concession in light of its earlier argument that it was entitled to the rents by force of post-bankruptcy, de facto possession. Reply Brief, p. 8. By its own concession, Appellee is not entitled to the rents, for it has no deficiency. Assuming that at this late date Appellee moved to sequester the rents upon a showing of a deficiency, the rents in controversy would not be affected, since only the rents falling due after filing the petition for sequestration are subject to such claim. Investors Syndicate v. Smith, 105 F.2d 611, 621-622 (9th Cir. 1939); In re Humeston, 83 F.2d 187 (2nd Cir. 1936).

Appellee, in its Brief, p. 19, seems also to maintain that the modified restraining order was a sequestration of rents. That order was obtained ex parte on a verified petition which alleged that Appellee had obtained possession of the apartment building on or about September 24, 1964 (Petition, etc., p. 2, Supplemental Record on Appeal). These allegations were found untrue by the Referee and the District Court on review. The possession achieved by Appellee through the device of this ex parte modification did not effect a sequestration of rents for its benefit, since Appellee was thereby to collect the rents "accountable to this Court" (R. 17, line 24). The modification could not be deemed to have given Appellee any substantive rights, since Appellant's predecessor in interest had no opportunity to be heard in those proceedings.

V. THE BANKRUPTCY ESTATE HAS LOST THE RENTS IN QUESTION BY THE ORDER APPEALED FROM.

Appellee's last major contention is that the bankruptcy estate had nothing to lose by the award of rents to Appellee during the proceedings. The burden and direction of this argument is obscure. This argument concedes that this court, in the event the District Court's order is affirmed, should remand the cause to the Bankruptcy Court for an accounting under the Order Modifying Temporary Restraining Order of October 4, 1964 (R. 16). Yet, Appellee claims it is entitled to what it terms "net rents." Reply Brief, p. 21.

The contention that the "result in terms of net asset values added to the estate would be the same as if appellant himself had received the rents," Ibid., is erroneous. First, the rents are presently lost for purposes of payments of costs of administration of the bankruptcy estate and taxes. Such expenses are properly deducted, even when the rents are validly sequestered. Florida Nat. Bank of Jacksonville v. United States, 87 F.2d 896 (5th Cir. 1937). Second there were two other liens upon the subject property whose holders would receive the first benefit of any reduction of the amount first secured to Appellee (Findings, R. 21).

Third, Appellee ignores the economic reality of the market for sale of interests owned by bankrupts and insolvent estates. The fact of the matter is that a bankruptcy estate can rarely realize

the fair market value of its equity in mortgaged property, since any potential buyer would prefer to await the foreclosure sale for the lower price. In the present case, foreclosure was pending and imminent during the period that Appellant owned the bankrupt's equity. Fourth, Appellee's claim, that it should have the rents because it could not matter who received them, militates just as strongly against Appellee's position. There is no reason, where as here the mortgage is fully secured, to give the mortgagee the rents and place the risk of the marketplace upon the trustee in bankruptcy. Certainly, such a course is insensible where, as here, the mortgagee has no perfected security interest in rents.

C. CONCLUSION

The Appellee here, unlike the real property mortgagee in Pollack v. Sampsell, supra, did not have a valid lien in the rents at the time the petition in bankruptcy was filed. The property then became in custodia legis from the filing of the petition. It followed that a lien in the rents could not "thereafter be obtained nor proceedings be had in other courts to reach the property . . . " Stratton v. New, 283 U. S. 318, 321 (1930).

The equitable defenses, which were never raised by the petition to sequester or in the Answer to Petition for Order to Show Cause, are inappropriate for that reason and because Appellee had no deficiency. It is therefore urged that the lower court's decision be reversed with directions to remand the cause to the bankruptcy court for further proceedings consistent with the ruling the Appellee has no lien in the rents in question.

Respectfully submitted,

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By_____

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ATTORNEY'S CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated and executed this 27th day of June, 1966.

WILLIAM T. RICHERT

No. 20,585

IN THE

United States Court of Appeals

For the Ninth Circuit

ANITA T. OWENS,
Appellant,
vs.
RAYMOND WHITE, JOHN C. McCARTER, ALFRED POPMA, and ST. LUKE'S HOSPITAL, a corporation,
Appellees.

Appeal from Summary Judgment of Dismissal
of the United States District Court
for the District of Idaho,
Southern District
Honorable Ray McNichols, Judge

APPELLANT'S OPENING BRIEF

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No. 20,585

IN THE

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For the Ninth Circuit

ANITA T. OWENS,
Appellant,

vs.

RAYMOND WHITE, JOHN C. MCCARTER, ALFRED POPMA, and ST. LUKE'S HOSPITAL, a corporation,
Appellees.

Appeal from Summary Judgment of Dismissal of the United States District Court for the District of Idaho, Southern District

Honorable Ray McNichols, Judge

APPELLANT'S OPENING BRIEF

STATEMENT OF JURISDICTION

This action was commenced on October 11, 1963. Motions, premised upon the allegation that the statute of limitations set forth in Section 5-219, Idaho Code, had run were filed on the 26th day of November, 1963 and the 3rd day of December, 1963. Thereafter, on the 20th day of December, 1963, the District Court entered its order granting the motion to dismiss without leave to amend. On January 17, 1964, Appellant filed her

notice of appeal to the United States Court of Appeals for the Ninth Circuit. Briefs and oral argument were submitted by the parties, and, on the 12th day of March, 1965, this Honorable Court reversed the judgment, remanding the cause for further proceedings.

Pursuant to certain language contained in the opinion of this Honorable Court, the District Court, on June 2nd, 1965, held an evidentiary hearing to determine whether the "discovery rule" should be applied to determine when Appellant's cause of action accrued. Thereafter, on the 22nd day of June, 1965, the District Court filed its Memorandum Decision, including findings of fact and conclusions of law, determining that the "discovery rule" ought not to be applied in this case. On the 19th day of July, 1965, the District Court filed findings, conclusions and a joint order adverse to Appellant herein and, thereafter, Appellant having amended her Complaint, the Appellees moved for Summary Judgment. On the 23rd of August, 1965, the motion for summary judgment came on for oral argument. On the 22nd day of September, 1965, the motion for summary judgment having been granted, the District Court entered its judgment of dismissal with prejudice.

Appellant duly filed her notice of appeal, statement of points on appeal and designation of contents of record on appeal. Each of these documents were filed on or about the 16th day of October, 1965.

The jurisdiction of the District Court was properly invoked, the Court having original jurisdiction of the

action under 28 U.S.C.A., Section 1332. This said jurisdiction existed because the parties are citizens of different states and the amount in controversy exceeds the sum of $10,000.00, exclusive of interest and costs. This Honorable Court has jurisdiction to review the order and judgment entered by the District Court under the provisions of 28 U.S.C.A., Section 1291.

STATEMENT OF THE CASE

Appellant's amended complaint was filed pursuant to motion and leave granted by the District Court. The said amended complaint sets forth four causes of action or claims for relief. Omitting the jurisdictional allegations, the complaint alleges in substance that Appellees White, Popma and McCarter were and are physicians and surgeons duly licensed to practice under the laws of the State of Idaho and that Appellee McCarter was and is a duly licensed pathologist. During the month of August, 1951, plaintiff employed Appellee Popma to examine and diagnose a lump in plaintiff's left breast. Thereafter, plaintiff-Appellant was advised by Appellee Popma that a biopsy should be done on this lump and Appellee White was employed to perform the biopsy. The biopsy was performed and Appellee White at first advised Appellant that the lump was not cancerous, later informing her that the first diagnosis had been in error, that the lump was malignant and that it was necessary to perform a certain surgical procedure known as a "radical", involving the removal of Appellant's left

breast, the stripping of the lymph glands from under her arm. Further, that in fact the tissue removed during the biopsy was benign, i.e., not cancerous, and that Appellant did not discover this fact and that the "radical" surgery was unnecessary until the Fall of 1962; that prior to that time plaintiff was not aware of any fact which could put her on inquiry or give her notice that the lump in her breast was in fact benign, that plaintiff could not have discovered such fact, i.e., that the lump was benign, at any earlier date through due and reasonable diligence. Further, the amended complaint alleges that Appellant was a married woman up to and including the 1st day of September, 1959, and that Appellant continued to be the patient of Appellee White and to rely upon his skill and judgment up to and including the 1st day of September, 1961. Appellee White is alleged to have absented himself from the state of Idaho, remaining absent ever since, on or about the 1st day of September, 1961. The first claim for relief further alleges that Appellee McCarter was negligent in his examination and analysis of the tissue taken from the lump in Appellant's left breast and that he negligently misdiagnosed the said tissue as being cancerous.

In the second claim for relief, Appellee White is alleged to have acted negligently in failing, after receiving two conflicting diagnoses from Appellee McCarter, to use due and proper care to determine whether the tissue taken from the lump in Appellant's left breast was in fact cancerous. In the third claim for relief, the performance of the biopsy and the

tissue analysis being alleged to have been under the exclusive control and management of Appellees, it is pleaded that Appellees acted negligently in conducting the handling, preparation, examination and analysis of the tissue taken during the said biopsy and that, had the aforesaid handling, preparation, examination and analysis been properly done, a correct diagnosis would have been made and Appellant would not have undergone an unnecessary, painful and disabling operation. In the fourth claim for relief, it is alleged that Appellees, following the "radical" surgery, unnecessarily, negligently and carelessly subjected the Appellant to extensive radiation treatments.

The crucial allegations of the pleadings, for the purpose of this appeal, are then those dealing with Appellant's marital status, the absence of Appellee White from the State of Idaho, and that Appellant did not discover the negligent misdiagnosis and the fact that the lump in her left breast had been benign until the Fall of 1962, coupled with an absence of any fact which could put Appellant on inquiry or give her notice that the diagnosis had in fact been in error. Coupled with this last mentioned allegation, are the pleaded facts that Appellant continued, until September of 1961, to be the patient of Appellee White and to rely upon his skill and judgment.

STATEMENT OF FACTS

As previously stated, the District Court held a fact-finding hearing, the transcript record of which is among the papers brought up on this appeal. Since the determination of this appeal turns not only upon those facts alleged in Appellant's Complaint, but also upon the evidence adduced in support of and in opposition to the pleaded allegations, it is essential to set forth a brief recitation of this evidentiary matter. In doing so, page citations will be given wherever possible, coupled with line citations when necessary. Citations to pages of the transcript of the June 2nd hearing will be designated with an "R."

Appellee Raymond L. White testified both as an adverse witness called by Appellant and in his own behalf. He first saw Appellant on August 22, 1951. On the 23rd or 24th of August, 1951, he did a biopsy of her left breast; on September 1st, 1951, a radical mastectomy of the left breast was performed by him. (R. 25:1-18.) He continued to see Appellant for routine post-operative visits and necessary dressings after surgery until December of 1951 and then saw her early in the Spring of 1952. (R. 25:23-25.)

In April of 1956, Appellee White saw Appellant again for a routine physical examination and discovered that she had a tumor of the right lobe of the thyroid. Thereafter, he performed a thyroidectomy. (R. 26:4-14.) He continued to see Appellant intermittently during the year 1956, corresponded with her and believed that he had seen her in 1957. (R. 26:20-27:4.) The correspondence was in regard to the guid-

ance which she needed for medical treatment and maintenance of her metabolism, related to the thyroidectomy. (R. 27:5-11.)

Appellee White saw Appellant as a doctor twice in 1958. When Appellant moved to California in 1959, she continued to correspond with Appellee White and ask him for assistance in connection with renewing certain prescriptions and in locating a physician to treat her in California. (R. 31:10-25.)

Called as a witness in his own behalf, Appellee White testified that he last saw Appellant in relation to the breast problem in the month of April of 1952. He next saw her on January 27, 1956. (R. 188:13-19.) He did not see Appellant in 1957, but saw her in August of 1958, at which time he did a complete physicial examination as a general checkup for health. (R. 189:13-19.) The letter from Appellant, asking for renewal of prescriptions and assistance in locating a physician in California was received in 1959 and his reply was dated October 31, 1959. (R. 189:20-25.)

At the time of the biopsy, the lump in Appellant's left breast was removed. The second surgery, i.e., the radical mastectomy, involved the removal of the tissue of the breast and certain surrounding tissue. (R. 193:11-21.) Following the biopsy, Appellee White told Appellant that on gross examination of the tissue removed, i.e., the tumor mass per se, it appeared to be benign, but that they would have to wait for the microscopic sections in order to make a final diagnosis. (R. 194:8-17.) Following the radical mastectomy, Appellee White told Appellant that she had cancer

and he expected her to accept this as a fact. (R. 205:17-24.) He also told her that it was his considered conclusion that she had cancer and that she should have follow-up service. (R. 207:3-8.)

Appellant herein testified as a witness in her own behalf. In the year 1951, she was a married woman; she was divorced in August of 1959. (R. 99:13-19.) She had nurse's training at Good Samaritan Hospital in Portland, Oregon, becoming a licensed registered nurse in 1943. (R. 147:7-16.) In 1948, she received a bachelor of science degree in education from the University of Utah, this being essential to teaching nursing. (R. 147:19-147(a):8.) In her training and experience there was no specific study of the subject of breast tumors. (R. 147(a):9-13.) In the Fall of 1948, she was medical nursing supervisor, Department of Medicine, for a Dr. Wintrobe in Utah. He was a hematologist and this involved some special work in the field of cancer. (R. 155:22-156:5.) As an undergraduate, she had cared for patients who were being treated for breast cancer, but had not done so since graduation. (R. 155:15-21.) She did not, through her association with Dr. Wintrobe, develop a special interest in the field and subject of malignancies. (R. 156:6-9.)

To the extent that Appellant had any specialty within the field of nursing, it was in the field of medicine rather than surgery. (R. 151:1-7.) She did not, as a nurse, make it her personal business to read about breast cancer and inform herself on the subject; as a patient, she did so in 1951 at St. Luke's Hospital. (R. 151:19-152:6.)

Appellant knows a little about pathology, but nurses do not work in pathology, this field being reserved for technicians. (R. 118:18-119:1).

Appellant had lived in Salt Lake City and worked at Salt Lake General Hospital for about a year and a half, following which she lived in Pocatello, Idaho, for several months. She then came to Boise, Idaho, where she did not work as a nurse. (R. 100:18-101:4). In August of 1951, while she was living in Boise, she discovered a lump on her breast. She telephoned a doctor with whom she had worked at Salt Lake General Hospital, told him she was new in Boise and asked if he knew anyone in Boise she could see. This doctor recommended to her Appellee Popma. (R. 101:5-25.) She saw Appellee Popma who examined her and advised her that the lump should be surgically removed and examined, i.e., that a biopsy be done. (R. 102:1-10). Appellant was furnished by Appellee Popma with a list of three surgeons, including the name of Appellee White. She made inquiries concerning Appellee White, as she knew that if the biopsy turned out to be malignant, a radical would be done. (R. 102:11-103:6.) She sought advice and selected what she believed to be the best doctor. (R. 103:6-9.)

At this stage, Appellant, through her work with doctor Wintrobe, a leader in the field of malignant blood disorders, had the feeling that she should take her time in selecting a surgeon and then, once the surgeon was selected, do precisely what the surgeon advised. (R. 103:11-24.)

On August 26, 1951, Appellee White performed the biopsy. That biopsy was followed by his advice to her

that the tissues were benign. The next day, he telephoned to tell that there had been a mistake, that they found some malignant tissue cells and that she was to be in the hospital the next morning. (R. 104: 11-24.) The radical mastectomy was performed by Appellee White on August 28, 1951. (R. 104:23-105:1.)

Immediately following the radical mastectomy, Appellee White discussed with Appellant the report which showed a finding of cancer. (R. 105:25-106:1.) She was concerned whether she was going to live or die and Appellee White told her: "Well, of course, I don't know, but we are going to do everything we can to see that you live." and Appellee White then outlined the follow-up treatment to be pursued. He told her that all of the tissue near the site of the tumor which they could excise would be taken and that since a pregnancy could activate a malignancy, they would radiate the chest and the ovaries to prevent pregnancy. (R. 106:4-25.) She subsequently underwent this series of radiological treatments. (R. 107:1-9.)

This brought on a menopause at the age of 30; she underwent the treatments because she believed that she had cancer. The reason she stayed with Appellees as her doctors was that she believed in them. (R. 107:12-25.)

In February of 1952, Appellant moved to Pocatello. (R. 108:3-10.) To the best of Appellant's recollection, in the years 1952 through 1956, she saw Appellee White once. In examining Appellant in 1956, Appellee White found an enlargement in the thyroid and said, "In view of your history, Anita, I think we had better get it out." (R. 112:8-113:5.)

In the years 1956 through 1959, Appellant testified that she saw Appellee White for check-ups and examinations at least once per year. She had complete physical examinations and blood work, and received considerable reassurance from Appellee White. (R. 115:3-116:1.)

Examined in regard to her conversations with Appellee White following the radical mastectomy Appellant testified that Appellee White, referring to the malignant tissue, said, "I think we got it all." and showed her the pathology report, which showed they had found no malignancy. (R. 116:13-25.) As Appellant understood the pathologist's reports (Exhibits 5 and 6) the report from the biopsy (Exhibit 6) showed the existence of a lesion and cancerous tissue, the report from the radical mastectomy (Exhibit 5) showed that there had been a carcinoma in the lesion, but that no malignancy was found in the surrounding tissues. (R. 164:14-168:1.)

In 1959, Appellant moved to California. She stopped in Boise on her way to report to her job and saw Appellee White at that time. She had been doing some volunteer work for the American Cancer Society prior to that time and was aware that, in terminology of people working with cancer, they do not say that the patient is cured, only that they have survived for a certain period of time. She consulted with Appellee White who advised her that in his opinion she could work and get along alright. (R. 116:25-117:19.) In California, Appellant went to work for the Veterans Administration Hospital as a staff nurse, later becoming a nursing supervisor. (R. 117:23-118:12.) She

originally worked at Livermore, California, and then was sent in April of 1960 to Palo Alto to help open the new Veterans Administration Hospital there. (R. 119:2-18.) At Palo Alto, Appellant met Dr. Shaw, an oncologist, a specialist in cell structures. (R. 119:19-120:7.) Dr. Shaw gave a lecture involving the early detection of breast malignancies. (R. 120:19-25.) This was in 1962 and, since she had not had a physician since she left Idaho, Appellant decided to ask Dr. Shaw if he would follow her case, Dr. Shaw agreeing to do so. (R. 121:7-25.) He said that she should have continued check-ups and asked her to sign a consent form so that her prior medical records could be sent to him. (R. 122:1-25.) During August of 1962, after he had obtained the records, Dr. Shaw called her to his office and told her that she had not had cancer. (R. 123:12-126:1.) What Dr. Shaw told her was that the Stanford Laboratory had examined the slides and had reached the opinion that they did not show cancer. He also said that he would communicate this to Appellee St. Luke's. (R. 175:5-15; 177:5-9.) She at this time concluded in her own mind that she had a claim for malpractice and consulted an attorney. (R. 178:17-25.)

Appellee McCarter testified that he had been, since the year 1951 until the present time, in charge of the pathology department at St. Luke's Hospital. (R. 71:13-72:3.) In or about September of 1962, he received a letter from Dr. Shaw advising him of the results of the re-examination of the slides in this case. (R. 78:2-25.) This letter was marked as Exhibit 9. Slides are constructed by placing a tissue specimen

between two pieces of glass and sealing them so that they are airtight. (R. 85:25-86:3.) The slides in this case are still in Appellee McCarter's custody. (R. 86:4-7.) All of the records and files of St. Luke's Hospital concerning Appellant are still in existence and available. (R. 88:1-9.) This file includes the opinions and findings and diagnoses and all records thereof and all of the reports and summaries. (R. 88:12-25.) Called as a witness in his own behalf, Appellee McCarter testified that the slides were fourteen years old and that there had been some deterioration which, to some degree, made it more difficult to interpret the slides. (R. 240:1-19.) This fading is in color and the slides are not as distinct in appearance as they were in 1951. (R. 246:19-25.) However, it was possible to make a diagnosis from these slides with "proximate certainty" as of the time of the hearing in this case. (R. 254:1-7.) The certainty is not as great as it would have been five or even two years prior to the hearing. (R. 254:9-14.) However, this was with approximately the same degree of certainty as fifteen years prior to the hearing.

In attempting to establish the difficulty of trying this law suit, Dr. McCarter further testified that little was known about sclerosing adenosis (the diagnosis arrived at by the Stanford Laboratory from Appellant's slides) in 1951, that a great deal of information had developed since that time. (R. 241:1-22.) Other than a Dr. Carl in Twin Falls, Idaho, Appellee McCarter could recall no pathologist who had been in the immediate area in 1951 and was still in the same geographical area around Boise. (R. 243:4-20.)

Appellee White was also called as a witness in his own behalf. On cross-examination, he testified that, following the radical mastectomy, he believed that Appellant had had cancer. He informed her of this. He certainly communicated this to her in such a manner that he expected her to accept it as a fact. It was part of his treatment to convince her that she had a situation that she had to live with. (R. 205:6-206:1.) It is part of good medical procedure to tell a patient following surgery for cancer, that they should have follow-up and periodic check-ups. He told Appellant that it was his considered conclusion that she had had cancer and that she should have follow-up service. (R. 206:25-207:8.)

SPECIFICATIONS OF ERROR

I

The Evidence is Legally Insufficient to Support the Findings of Fact Entered by the Court

II

The Trial Court Applied an Erroneous Legal Standard in Determining the Applicability of the "Discovery Rule"

III

The Trial Court Erred in Granting the Motion to Dismiss

ARGUMENT

I

THE EVIDENCE IS LEGALLY INSUFFICIENT TO SUPPORT THE FINDINGS OF FACT ENTERED BY THE COURT

In the Memorandum Decision filed June 22, 1965, the Trial Court, in support of its conclusion that the "discovery rule" should not be applied in this case, made twelve findings of fact. In large part, the Summary Judgment of Dismissal from which this appeal is taken, depends upon these findings of fact. Appellant moved the Court to amend and make supplemental findings of fact, tendering some 33 proposed findings of fact. The motion was denied and the final judgment of the Trial Court incorporated the prior findings of fact by reference.

It is Appellant's intention to demonstrate, in this portion of the brief, that certain of the findings of fact made by the Trial Court are supported by no or insufficient evidence. Further, certain of the findings of fact tendered by Appellant should have been adopted by the Court. As a preliminary matter, however, it is necessary to discuss the legal standard applicable to the making of such findings of fact. This being a diversity action, State law, including that governing the accrual of a cause of action and the statute of limitations, governs. *Ragan v. Merchant Transfer and Warehouse Company, Inc.*, 337 U.S. 530, 69 S. Ct. 1233, 93 L. Ed. 1520 (1949). State rules as to the burden of proof govern in this diversity action. *Palmer v. Hoffman*, 318 U.S. 109, 63 S. Ct. 477, 87 L. Ed. 645, 651 (1943).

Under Idaho law, where the statute of limitations is set up in an answer, it is error to grant judgment on the pleadings, as the case should proceed to proof. *Chemung Mining Company v. Hanley,* 9 Idaho 786, 77 Pac. 226 (1904). The "discovery rule" dealing with the accrual of a cause of action for medical malpractice is new to Idaho, having been first established in the case of *Billings v. Sisters of Mercy of Idaho,* 86 Idaho 485, 389 P. 2d 224 (1964). Nevertheless, Idaho has had extensive experience with an identical rule applied to the accrual of a cause of action for fraud. Thus, in *Gerlach v. Schultz,* 72 Idaho 507, 244 P. 2d 1095 (1952), it was noted that, in an action for fraud, the statute of limitations starts to run only from the time when the fraud is discovered or, in the exercise of reasonable diligence, should have been discovered. This case involved an appeal from a trial to the Court alone, sitting without a jury. Here, despite the fact that the fraud could have been discovered by the inspection of instruments which the defendant had caused to be recorded and which thus gave "constructive notice", the Appellate Court found the evidence sufficient to sustain the Trial Court's finding that the statute of limitations had not run to bar the action. Cf. *Galvin v. Appleby,* 78 Idaho 457, 305 P. 2d 309 (1956). Where the statute of limitations is pleaded in an answer, it becomes an affirmative defense and the burden of proving this defense is upon the defendant. *Pauley v. Salmon River Lumber Company,* 74 Idaho 483, 264 P. 2d 466, 471 (1953).

Thus, while the Trial Court manifestly believed that the defense of the statute of limitations presented a

preliminary matter to be disposed of under Federal law, the law of Idaho governed; the Idaho law placed the burden of proof upon the defendants and, in accordance with *Chemung Mining Company v. Hanley,* supra, the defense should have been resolved by the trier of fact. Both the original and first amended complaint in this case demanded trial by jury.

In essence, this case comes before this Honorable Court on appeal from a summary judgment. The defense of the statute of limitations may properly be asserted by motion for summary judgment. *Gifford v. Travelers Protective Association,* 153 F. 2d 209, 211, 9th Cir. 1946. Appellant concedes that the device of summary judgment is available in this type of case; Appellant denies that the device was properly applied.

Summary judgment is proper, under Rule 56, Federal Rules of Civil Procedure, only where the moving party is entitled to judgment as a matter of law, where it is quite clear what the truth is, and that no genuine issue remains for trial. *Sartor v. Arkansas Natural Gas Corporation,* 321 U. S. 620, 627, 64 S. Ct. 724, 88 L. Ed. 967 (1944); *Poller v. Columbia Broadcasting System,* 368 U. S. 464, 468, 82 S. Ct. 486, 7 L. Ed. 2d 458 (1962). The burden is upon the moving party to show clearly that there is no genuine issue of fact and the function of the Trial Court is to determine whether such issue exists, not to resolve the issue. *Byrnes v. Mutual Life Insurance Company of New York,* 217 F. 2d 497, 9th Cir., 1954. Unless the pleadings, depositions, and admissions in the file fail to show the lack of a genuine issue as to any

material fact, the motion for summary judgment should be denied. *Sequoia Union High School District v. United States,* 245 F. 2d 227, 9th Cir., 1957.

Where the determination of a summary judgment motion requires the Trial Court to choose between conflicting possible inferences from the evidence, the motion should be denied. The drawing of inferences arising from the evidentiary facts, whether these evidentiary facts be disputed or not, is for the trier of fact. *Sarkes Tarzian, Inc. v. United States,* 240 F. 2d 467, 470, 9th Cir., 1957. Cf. *Vokal v. United States,* 177 F. 2d 619, 621, 9th Cir., 1949. On appeal from the granting of summary judgment, the allegations of fact in the non-moving party's reply to the motion are to be accepted as true. *Apache Land and Cattle Company v. Franklin Life Insurance Company,* 145 F. 2d 964, 9th Cir. 1944.

Appellant's research has uncovered three Federal cases dealing with the granting of summary judgment on the grounds that the statute of limitations had run where the date of accrual of the cause of action by reason of "discovery" was in dispute. In each of these cases, analyzed below, the Trial Court's action was reversed.

In *Tracerlab, Inc. v. Industrial Nucleonics Corporation,* 313 F. 2d 97, 1st Cir., 1963, the Court was dealing with a Massachusetts statute which provided that the period of limitations where there was a fraudulent concealment of the cause of action, started to run from the time when the plaintiff discovered its existence. Summary judgment of dismissal had been granted on the ground that the plaintiff's discovery

came more than two years prior to the filing of the complaint. The depositions of plaintiff's principal officers showed that they "suspected" the pirating of their trade secrets (which gave rise to the cause of action) more than two years prior to filing. Nevertheless, their attempts to get the facts had proved unsuccessful until sometime within the statutory period. The First Circuit Court of Appeals held that it must view the evidence in the light most favorable to the party against whom the motion had been granted and that, as there was a genuine issue of material fact as to whether the plaintiff had knowledge, as opposed to suspicion, more than two years prior to filing, the summary judgment of dismissal was reversed.

R. J. Reynolds Tobacco Company v. Hudson, 314 F. 2d 776, 5th Cir., 1963, was a diversity case governed by Louisiana law. It involved cancer caused by the defendant's tobacco products. Summary judgment was granted on the ground that plaintiff had failed to bring his action within the statutory period following his knowledge of the fact that he had cancer. Louisiana, in *Perrin v. Rodriguez*, 153 So. 555, had adopted the "discovery rule" in medical malpractice cases. Drawing an anology to such cases, the Court held that the statute would start to run only from the time when the plaintiff knew or should have known that he had an actionable injury which was attributable to his smoking. After reciting the usual rules as to summary judgment being proper only when there was no issue of fact, the Court stated:

> ". . . we hold that prescription commenced to run from the time the disease manifested itself to the point where Hudson knew, or should have

> known, that the damages he sustained, which were the subject of this suit, resulted from smoking the defendant's tobacco products. When this took place is a jury question . . ."
>
> *R. J. Reynolds Tobacco Company v. Hudson,* supra, 314 F. 2d at 786.

Sheets v. Burman, 322 F. 2d 277, 5th Cir., 1963, was a medical malpractice action. Plaintiff alleged that, during surgery in February of 1947, defendant negligently left a curvilinear surgical needle in her abdomen and that she did not discover that this was the cause of her continuing pains until October of 1957. The action was filed November 12, 1959. The operation took place in Indiana, but defendant moved from Indiana to Louisiana in 1950, returning to Indiana in 1953, and examining plaintiff on one or two occasions in 1954. In that same year, he moved to Mississippi. The case involved a sporadic series of visits by plaintiff to defendant and a substantial issue as to whether or not that constituted continuing treatment and care by defendant. Citing and relying upon *Perrin v. Rodriguez,* supra, and *R. J. Reynolds Tobacco Company v. Hudson,* supra, the Court held that there were disputed issues of fact as to when the doctor-patient relationship ended and when knowledge of the act causing the damage was acquired. This being so, the granting of summary judgment was improper.

Thus, there is presented to this Honorable Court a serious question as to whether, in making its findings of fact, the Trial Court should have applied a

rule of the preponderance of the evidence or, under the Federal authorities just above cited, the usual rule applicable to motions for summary judgment. In any event, it is clear under Idaho law, that the burden of making out the defense was upon Appellees. As to some of the findings of fact made by the Trial Court and some of the proposed findings of fact rejected by that Court, the preponderance of evidence was for Appellant. As to others, there were disputed issues of fact which, it is very respectfully submitted, should have been left for resolution by the jury.

The Trial Court's first finding of fact was:

> "That the plaintiff was, for a number of years prior to the surgery, a registered nurse, actively pursuing her profession, and was a college graduate with a degree of bachelor of science in that field."

In fact, the evidence adduced showed that Appellant's degree was in education in order that she might teach nursing.

The second finding of fact was:

> "That she remained, during all of the time after the surgery, actively in the nursing profession, working in hospitals, and was also active in cancer prevention work."

The only evidence upon this point was the testimony of Appellant herself. She testified that she had never, since she became a registered nurse, worked in the operating room. (R. 154:1-6.) Following the surgery, when Appellant moved to Pocatello, she worked at Bannock Memorial Hospital, teaching nursing. (R.

108:25-109:7.) Between 1952 and 1956, she was in Montana and did not work. (R. 114:7-20.) In 1956 she started doing volunteer work for the American Cancer Society and they paid her way to Boise twice a year. (R. 114:20-25.) In 1959, she returned to active nursing work when she moved to California and accepted a job with the Veterans Administration. (R. 117:23-118:4.) Appellant's cancer prevention work with the American Cancer Society consisted of organizing volunteers to teach cancer prevention and to collect money on the lay level and without pay. (R. 183:13-25.)

The seventh and eighth findings of fact recite that Appellant knew at all times that her hospital records and the slides on which the diagnosis had been predicated were available and that she made no investigation to determine the accuracy of this diagnosis. These findings of fact are, in and of themselves, correct; nevertheless, there was no evidence that Appellant ever, until Dr. Shaw communicated the findings of the Stanford Laboratory to her, had any reason to doubt the accuracy of the original diagnosis.

The tenth finding of fact was to the effect that the slides are now deteriorated to some degree. This also is, in and of itself, correct. Nevertheless, Appellee McCarter testified that he was able, a few weeks prior to the hearing, to reach a diagnosis from examining the slides. (R. 254.)

The Trial Court's twelfth finding of fact is to the effect that, while Appellant sometimes sought out Ap-

pellee White for medical attention, she also saw and consulted other physicians and did not rely solely on Dr. White for medical advice and treatment. There is a further finding that there was not a continuing relationship of doctor and patient after the post-operative surgery and treatment in the usual sense. The testimony revealed that, in 1956, Appellee White advised her to have a thyroidectomy and premised such advice upon her past history of cancer. Further, Appellant testified that she relied upon Appellee White in the field of cancer. It was apparent from the evidence that, insofar as continuing observation and treatment of Appellant for the original malignancy was concerned, Appellee White was her only physician up to and including the time when she asked Dr. Shaw to care for her. Thus, Appellant continued to rely upon Appellee White, his original diagnosis, his continuing advice, and his continuing observation and treatment up to the Fall of 1962.

Turning to Appellant's proposed findings of fact which were rejected by the Trial Court, the second proposed finding was to the effect that Appellant was not trained, nor did she qualify as a pathologist, nor was she skilled in the diagnosis of cancer or the reading of microscopic slides, x-rays, or making any diagnosis of cancer. The sole evidence on this point was the testimony of Appellant which was in accord with the proposed finding. It should have been adopted.

The third proposed finding was to the effect that Appellant, by reason of her schooling and profession, had adopted the philosophy that, once a physician or

surgeon had been selected, the patient should place their confidence in that physician or surgeon and follow his professional treatment and advice. The sole evidence produced on this point was the testimony of Appellant; based upon that testimony, the proposed finding should have been adopted. The eleventh proposed finding of fact was to the effect that Appellant, during the years following her surgery, had unlimited confidence in her doctors and was convinced that she had had cancer. The only testimony on this point was that of the Appellant, supporting the proposed finding. The Trial Court erred in rejecting this proposed finding.

The twelfth proposed finding of fact was to the effect that Appellant, when a lump on her thyroid was discovered by Appellee White, was advised by him that a thyroidectomy was in order because of her history and that such thyroidectomy was thereupon done. The only evidence in the record, including the testimony of Appellant and Appellee White, was in accord with this finding, which should, accordingly, have been adopted.

The thirteenth proposed finding of fact indicated that Appellant continued to see Dr. White for check-ups and continued to obtain her prescriptions for thyroid through him. This was in accord with the only evidence on this point and should have been adopted.

The twentieth proposed finding of fact was to the effect that the communication to Appellant by Dr. Shaw of the Stanford Laboratory diagnosis of the

tissue section was the first notice which she had which might reasonably have caused her to suspect or doubt the accuracy of the 1951 diagnosis. There was no evidence in this record that Appellant was, at any time between surgery and the Fall of 1962, advised or informed that there was any reason to doubt the accuracy of Appellee's diagnosis; accordingly, the proposed finding should have been adopted.

The twenty-second proposed finding recited that there had been no change in the shape, size, variation or deviation from normal structure of the cells contained within the tissue section slides and that they were still available, and that diagnosis and evaluation could be made from them. This was in accord with the testimony of Appellee McCarter and the proposed finding should have been adopted.

The twenty-third proposed finding of fact was simply that Appellees McCarter, White and Popma were all living and available to testify in their own defense. This was manifest from the record and the Court should have adopted this proposed finding.

In short, the Trial Court, whether applying a preponderance of the evidence test or the usual rules applicable to motions for summary judgment, should have found the following: Appellant was a registered nurse and had received a bachelor of science degree in education. She had worked as a medical, as opposed to a surgical, nurse and had never since graduation treated or cared for a patient suffering from breast cancer. In August of 1951, she discovered a lump in her breast and sought medical attention. Thereafter,

Appellees performed a biopsy, consisting of a surgical removal of the lump. Tissues taken from this lump were placed in glass slides. Initially, the diagnosis reported to Appellant was that these tissues were benign. One or two days thereafter, Appellant was informed by Appellees that the tissues were malignant. Relying upon Appellees' advice, Appellant submitted to a radical mastectomy, followed by six weeks of saturation radiation, which sterilized her. As part of his treatment, Appellee White endeavored to convince Appellant not only that she had suffered from cancer, but that follow-up care and periodic examinations were essential. He discussed with her the pathologist's reports, which showed the original lump to have been malignant, but indicated that all of the malignancy had been contained within that lump. Appellant, between the years 1951 and 1956, continued to see Appellee White periodically for examinations. In 1956, Appellee White advised her that, in view of her past history of cancer, a lump on her thyroid should be surgically excised. This was done. Appellee White continued to advise Appellant up to and including the time she moved to California in 1959. While Appellant had been involved in volunteer work for the American Cancer Society, this involved no special expertise in the diagnosis of cancer or in the examination of tissues. In 1959, Appellant moved to California. In 1962, Appellant consulted Dr. Shaw, for the sole purpose of continuing the periodic observations and treatments advised by Appellee White. Up to and including that time, Appellant had never suspected that there was any question as to the accuracy of the

original diagnosis in her case. Dr. Shaw obtained Appellant's consent for release of her prior medical records. Among those medical records forwarded to him by Appellee St. Luke's Hospital, were the slides of the tissue sections taken from the biopsy in 1951. Dr. Shaw referred these for pathological examination by the Stanford Laboratory and the report indicated that there had never been a malignancy, that there was a condition known as sclerosing adenosis, which is not malignant. Dr. Shaw so advised Appellant and also so advised Appellees. Within one year thereafter, suit was brought.

The slides were available at St. Luke's Hospital at all times, provided request was made. They are presently somewhat deteriorated, but, as admitted by Appellee McCarter, an accurate diagnosis can be made at this time from these slides. All of the individual Appellees are living and all of the medical records, reports and summaries are still available.

As will be developed, infra, even on the facts found by the Trial Court, the legal conclusion reached was erroneous. Nevertheless, a correct finding of fact would have made clear the applicability of the Idaho "discovery rule" and the Trial Court erred to the substantial prejudice of Appellant herein in making its erroneous findings of fact.

II

THE TRIAL COURT APPLIED AN ERRONEOUS LEGAL STANDARD IN DETERMINING THE APPLICABILITY OF THE "DISCOVERY RULE"

The Trial Court initially erred in applying a preponderance of the evidence rule and placing upon Appellant the burden of demonstrating that the statute of limitations had not run. This much was pointed out in argument under the first heading, above. In addition, the Trial Court, in applying or considering whether to apply the "discovery rule" specifically concluded as a matter of law: That plaintiff *could* have, by exercise of due diligence, discovered the alleged malpractice at any time after the surgery and treatment complained of." The "discovery rule" as enunciated in *Billings v. Sisters of Mercy of Idaho,* supra, is that the cause of action accrues when the patient learns, "or in the exercise of reasonable care and diligence *should* have learned . . ." of the negligent injury. *Billings v. Sisters of Mercy Hospital,* supra, 389 P. 2d at 232.

There is no doubt whatsoever in this case that Appellant *could,* at any time, have asked for a further pathological study. The crucial issue is whether she *should* have done so. There is a manifest difference between the availability of information and the possession of sufficient facts to require the party to make inquiry. As noted by the Idaho Court in *Gerlach v. Schultz,* supra, in an analogous situation, the ready availability of certain facts (there contained in recorded documents which gave constructive notice) does not mean that a party is charged with the duty

of having discovered those facts. In the case at bar, the issue is not whether it was possible for Appellant to acquire information, but whether the law imposed upon her a duty to do so.

As will be seen in the argument under the third heading, infra, the action of the Trial Court was in error. This error was largely contributed to by the Trial Court's application of a standard which made Appellant's cause of action accrue when she *could*, as opposed to when she *should* have discovered the negligence of Appellees herein.

III

THE TRIAL COURT ERRED IN GRANTING THE MOTION TO DISMISS

Following the rendition of its findings of fact, and conclusions of law, the Trial Court granted leave to Appellant to amend her Complaint. She did so, specifically alleging her marital status and Appellee White's absence from the jurisdiction. Thereafter, based upon the findings of fact and conclusions of law previously rendered, the Trial Court granted Appellees' motion for summary judgment. In granting this summary judgment of dismissal, the Trial Court erred.

As pointed out above, this case is governed by Idaho law, including that applicable to the accrual of a cause of action, the period and the tolling of the statute of limitations.

The negligent misdiagnosis was made on the 23rd or the 24th of August of 1951. The radical mastectomy was done on or about the 28th day of August, 1951. The radiation treatments were administered during the following six weeks. The action was filed on October 11, 1963. Section 5-219 of the Idaho Code provides a two year statute of limitations for an action to recover damages for an injury to the person. Section 5-201 of the Idaho Code requires that actions be commenced within the periods prescribed after the cause of action shall have "accrued".

The principal question raised is when the cause of action "accrued". That was before this Honorable Court on a prior appeal. In its decision (342 F. 2d 817) this Court reversed the prior judgment of dismissal and held that the "discovery rule" *might* be invoked. Continuing, the prior opinion also indicated that the question was one of law for the Court; that an Idaho Court would consider factors other than the diligence of the plaintiff in determining when the cause of action had accrued, i.e., that a diligent plaintiff might be barred prior to "discovery".

There is no blinking the fact that a portion at least of the Trial Court's error in this case is attributable to certain language found in the first appellate opinion. Despite natural reluctance to criticize that opinion, Appellant must point out that these portions had themselves no foundation in Idaho law. Despite any invocation of "law of the case", it is open to Appellant at this time to undertake that task. An Appellate Court on a second appeal may review and revise a

conclusion reached on the first appeal. The former decision is "the law of the case" only as to the lower court. *Messinger v. Anderson,* 225 U. S. 436, 444, 32 S. Ct. 739, 56 L. Ed. 1152; *Reynolds Spring Company v. L. A. Young Industries,* 101 F. 2d 257, 259, 6 Cir., 1939. Cf. *Mercer v. Theriot,* 377 U. S. 154, 83 S. Ct. 1159, 12 L. Ed. 2d 206. At most, the doctrine of "law of the case" involves a reluctance to exercise power which the appellate court doubtless possesses. *Lumbermen's Mutual Casualty Company v. Wright,* 322 F. 2d 759, 763, 5th Cir., 1963. This reluctance should be considerably lessened in a diversity case where the "law of the case" involves a misconception as to the governing State law.

Thus, this Honorable Court indicated (342 F. 2d at 819) that, under Idaho law, the accrual of plaintiff's claim was a question of law for the Court alone. While Idaho's first (and so far, only) experience with the "discovery rule" as applied to medical malpractice actions was that in *Billings v. Sisters of Mercy Hospital,* supra, Idaho has had considerable experience with that rule as applied to actions sounding in fraud. Thus, as indicated above, Idaho has held that where the defense of limitations is raised other than by demurrer, it is error to determine it by judgment on the pleadings. *Chemung Mining Company v. Hanley,* supra. The date of accrual by discovery has been left as an issue of fact for trial. *Galvin v. Appleby,* supra; *Gerlach v. Schultz,* supra. The invocation of the defense by answer places the burden of proof upon the defendant. *Pauley v. Salmon River Lumber Company,* supra. This Court's dictum, re-

grettably erroneous, led the Trial Court to deny Appellant her right to have the matter of her diligence determined by the trier of fact, i.e., the jury; also, it led the Trial Court to ignore the usual rules governing the granting of summary judgment.

Further, the first appellate opinion in this case (342 F. 2d at 820) at least intimated that Idaho would decline to apply the discovery rule absent such factors as a continuing relationship of doctor and patient, inherent difficulty of discovering certain wrongs, the availability of witnesses and records, etc. It was hinted that Appellant might be barred even though reasonably diligent if undue prejudice were shown. Each of these factors was stated as being at least possibly one to be considered prior to application of the discovery rule, rather than an integral part of such rule. Here, too, there was a misconception of the Idaho law.

The initial question of whether Idaho would apply the "discovery rule" to medical malpractice cases was answered in part in the landmark case of *Billings v. Sisters of Mercy of Idaho,* supra. The first appeal in this case involved the subsidiary question of whether the discovery rule would be limited to cases involving foreign objects left in the patient. It was determined that there was no such limitation.

In *Billings v. Sisters of Mercy of Idaho,* supra, surgery had been performed on July 10, 1946. The patient experienced considerable post-operative pain during the time that she remained under the defendant's care through the year 1947. From then through

1958, she consulted various doctors and from 1958 through May of 1961, she saw doctors outside the State of Idaho. In May of 1961, surgery was performed and a gauze sponge was found within her abdomen. Her complaint alleged that she had suffered continuous pain since the time of the 1946 operation and had consistently attempted to find out what was causing the pain.

Parenthetically, the defendant doctor was dead at the time of suit. In a lengthy and scholarly opinion, the Idaho Supreme Court considered four possible bases of a holding that the plaintiff's cause of action had not accrued until within two years of the filing of her complaint. The first three, i.e. continuing negligence, the contract theory and fraudulent concealment, were rejected. The doctrine of "continuing negligence" (that the doctor has a continuing duty to remove the object left in the patient and therefore is guilty of continuing negligence until the object is removed) was rejected, since the pleading showed that the plaintiff had severed her connection with this doctor many years prior to suit. (389 P. 2d at 230.) The Court found it impossible, in the context presented, to accept the "inherently unknowable harm" doctrine, finding it not much used in foreign object cases. (389 P. 2d at 230.) The use of the "contract" theory and the "fraudulent concealment" rule were likewise rejected. (389 P. 2d at 230.) The Court then stated that it was not a technical breach of duty which commenced the statutory period running, but the existence of a practical remedy. (389 P. 2d at 231.) Further, the plaintiff could not be guilty of

"sitting on her rights", because she could not sit on rights of which she was unaware. (389 P. 2d at 231.) The conclusion of the Court was that the cause of action did not accrue until the patient learned, or in the exercise of reasonable care and diligence *should* have learned of the presence of the foreign object. (389 P. 2d at 232.)

This landmark case merits such extensive treatment as it is the only Idaho law available on the precise question of the accrual of a cause of action for malpractice. Idaho would not allow lapse of time, standing alone, to bar invocation of the discovery rule. In *Billings v. Sisters of Mercy of Idaho,* supra, the suit was brought some fifteen years following the original allegedly negligent act. The continuance of a doctor-patient relationship was not necessary to invocation of the doctrine. *Billings,* supra, was a case in which that relationship had not existed for fourteen years prior to suit. Prejudice to the defendant doctor, by way of lack of availability of records and memory, would not bar invocation of the doctrine. *Billings,* supra, was a case in which the defendant doctor was dead.

In reaching its conclusion, the Idaho Court in *Billings v. Sisters of Mercy of Idaho,* supra, primarily relied upon two cases: *Seitz v. Jones,* Okla., 370 P. 2d 300 (1962) and *Heysman v. Kirsch,* 6 Cal. 2d 302, 57 P. 2d 908 (1936). Each of these cases adopted a pure discovery rule, each being a case of a foreign object negligently left in the body of the patient. In each case, it was determined that the statute of limitations commenced to run from the date when the

plaintiff discovered, or reasonably *should* have discovered, the negligent act of the defendant doctor.

In this Honorable Court's first appellate opinion in this cause, a series of cases was cited concerning the role of a continuing doctor-patient relationship in invocation of the discovery doctrine. (342 F. 2d at 820.) *Greninger v. Fischer,* 81 C.A. 2d 549, 184 P. 2d 694 posed the discovery rule in the alternative, i.e., that the statute of limitations would not ordinarily start to run until such time as the plaintiff discovered or should have discovered the wrongful act or the termination of the relationship of doctor and patient. It is impossible from the Court's opinion to determine how long a period elapsed between the termination of the relationship and the filing of the complaint. It apparently was less than the one year California statute of limitations. *Costa v. Regents of University of California,* 116 C.A. 2d 445, 254 P. 2d 85 (1953), like *Greninger,* supra, was outside the foreign object field. In this case, the doctor-patient relationship ceased on January 1, 1947 and the action was filed on November 5, 1948, more than one year (the California statutory period) after the termination of the relationship. The case sets forth the standard California discovery rule, i.e., that the statute of limitations does not start to run until the date of discovery, or the date when, by the exercise of reasonable care, the plaintiff *should* have discovered the wrongful injury. Parenthetically, the Court noted that the question of when the plaintiff discovered or should have discovered the wrongful act was one for the jury; the jury's determination in favor of the plaintiff

was sustained by evidence that the plaintiff did not know the origin of his injury until many months after he left the defendant's care. *Costa v. Regents of University of California,* supra, 116 C.A. 2d at 455.

Also cited in the prior appellate opinion in this case (342 F. 2d at 820) as to the crucial role of the continuing doctor-patient relationship was *Myers v. Stevenson,* 125 C.A. 2d 399, 270 P. 2d 885 (1954). In that case, the doctor-patient relationship ceased in May of 1946. The action was filed March 18, 1952, with an alleged date of discovery of July of 1951. The governing statute of limitations, however, was the special one set forth in Section 29 of the California Civil Code, providing for a six year period in cases of injuries during birth. The Court, in applying the usual discovery rule, noted that, so long as the physician-patient relationship continued, the patient is not ordinarily put on notice of negligent conduct of the physician upon whose skill, judgment and advice he continues to rely. *Myers v. Stevenson,* supra, 125 C.A. 2d at 402. It may be seen from this authority that the continuation of the doctor-patient relationship is a factor, *embraced within the discovery rule,* utilized in determining when the plaintiff *should* have discovered the wrongful act. *Hundley v. St. Francis Hospital,* 161 C.A. 2d 800, 327 P. 2d 131 (1958) was also cited (342 F. 2d at 820) as dealing with the continuation of the doctor-patient relationship. In that case, involving an allegedly unnecessary removal of the uterus, an ovary and a fallopian tube, in the face of pathological findings showing no malignancy, the

action was filed February 8, 1952. Evidence showed that the plaintiff had been a patient of the defendant until February 28, 1951, the surgery having taken place on May 25, 1949, and follow-up surgery on August 12, 1949. The Court, in holding that the statute of limitations did not commence to run until the plaintiff learned of the true pathological diagnosis, said,

> "Thus, in the absence of actual discovery of the negligence, the statute did not commence to run during such period . . . and this is true even though the condition itself is known to the plaintiff, so long as its negligent cause and its deleterious effect is not discovered . . ."

The California cases show that continuation or lack thereof of the doctor-patient relationship is but one factor, embraced within the discovery rule itself, utilized in determining the reasonableness of the plaintiff's conduct. The rule is simply that the patient is not expected to question the doctor's judgment during the life of the relationship. Thus, facts which, if brought to the plaintiff's attention after the termination of the relationship, might be held to put the plaintiff on notice, do not produce this result when communicated to the plaintiff while still under the defendant doctor's care. In the case at bar, the evidence was uncontroverted that, insofar as examination, treatment and advice concerning cancer was concerned, plaintiff-appellant relied solely upon Appellee White until she sought out Dr. Shaw in 1962; that itself was solely for the purpose of the type of continued care which Appellee White admittedly had

impressed upon her as being necessary in view of her prior alleged malignancies.

The inherent difficulty of discovering some wrongs, as a factor to be considered in determining whether to invoke the discovery rule, was emphasized in the prior appellate opinion (342 F. 2d at 820), citing *Agnew v. Larson,* 82 C.A. 2d 176, 185 P. 2d 851 (1947). There the Court first considered and rejected the defense assertion that the discovery rule was confined to foreign object cases. *Agnew v. Larson,* supra, 82 C. A. 2d at 181. The Court cited and relied upon *Hahn v. Claybrook,* 130 Md. 179, 100 Atl. 83, for the proposition that the statute began to run only when the plaintiff had sufficient facts to put her on notice and inquiry. Agnew had alleged that the defendant had negligently prescribed certain drugs which caused her to form a cancer in her breast, resulting in surgical removal. The defendant had been employed on January 27, 1942. Mrs. Agnew alleged that she discovered the cancer on February 8, 1945, the breast being removed on February 10, 1945. The complaint was filed on January 15, 1946; the statute of limitations involved was the California one year statute. In sustaining the plaintiff's right to maintain the action, the Court did comment upon the gradual growth of and difficulty of detecting cancer, going on to state:

> ". . . where injury proximately results from the negligent act of the physician and the patient has relied upon him for information as to his physical condition as well as for the results that may reasonably be anticipated from the introduction

> into his body of the foreign substance or matter, including drugs and medicines, the statute of limitations does not commence to run until the patient knows, or in the exercise of ordinary care *should have known,* the cause of his injury . . ." (Emphasis supplied.)
>
> *Agnew v. Larson,* supra, 82 C.A. 2d at 182.

In *Agnew v. Larson,* supra, the very nature of cancer, its insidious and gradual growth, obviously made it difficult for plaintiff to discover that she was being injured. In the case at bar, plaintiff-appellant knew instantly that she had lost her breast and certain associated tissues, the radical mastectomy having been performed. Nevertheless, considering that Appellee White told her she had cancer, repeated to her in 1956 that a thyroidectomy was necessary because of her history of cancer, and diligently persuaded her that, having suffered from cancer, she had to live with this fact, she had no reason to question the original diagnosis. Here was an inherently unknowable harm of a different sort. Only a pathologist could re-read the slides for Appellant. Only the move to California could and did require that she come under the care of a new physician with specialized knowledge in the field of cancer. Only that event triggered a reexamination of these slides, bringing home to her for the first time the fact that she had never, despite surgery, radiation, the thyroidectomy and the soothing supportive care, suffered from cancer. The harm here was as inherently unknowable, if not more so than, that in *Agnew v. Larson,* supra.

In *Seitz v. Jones,* supra, cited and relied upon in *Billings v. Sister of Mercy of Idaho,* supra, several of the California cases were collected and relied upon. Since *Seitz v. Jones,* supra, was a foreign object case, the emphasis was, naturally, upon cases involving like circumstances. *Ehlen v. Burrows,* 51 C.A. 2d 141, 124 P.2d 82 (1942), was a case where the defendant doctor left decayed and broken roots of teeth in the plaintiff's jaw. This was clearly a transitional case, holding that the statute of limitations started to run from the severance of the doctor-patient relationship, in a case alleging negligent care. It is interesting to note that the opinion reflects a complaint with no allegation as to when the existence of the broken roots was discovered. In the absence of such an allegation of discovery, the Court held that the statute of limitations had run, barring plaintiff's claim as to negligent care. However, emphasizing the continuing relationship, the alleged incompleteness of the treatment, with the roots left in, the Court held that as to the broken roots remaining in the plaintiff's jaw, the statute of limitations did not commence to run until the plaintiff discovered or *should* have discovered the harm.

Pellett v. Sonotone Corporation, 55 C.A. 2d 158, 130 P. 2d 181 (1942) is a foreign object case remarkable chiefly for the fact that the foreign object was a portion of a plaster mold left in plaintiff's ear after a fitting for a hearing aid. The Court announced the standard discovery rule, i.e., that the statute of limitations started to run when the plaintiff discovered,

or in the exercise of reasonable diligence, should have discovered the presence of the foreign object. The mold had been made on March 22, 1939; plaintiff learned of the plaster's presence on February 5, 1940 and the action was filed on May 10, 1940. There was no issue as to continuing care, as there had never been a doctor-patient relationship.

Bowman v. McPheeters, 77 C.A. 2d 795, 176 P. 2d 745 (1943), cited and relied upon in *Seitz v. Jones,* supra, is also a transitional case. Here, the "fraudulent concealment" doctrine, which was explicitly rejected in *Billings v. Sisters of Mercy of Idaho,* supra, was considered and, at least partially, relied upon. While a discovery rule was applied, this was explicitly as an adjunct to the fraud theory. The doctor-patient relationship was considered only in relation to the question of when the plaintiff discovered or should have discovered the "fraudulent concealment". Plaintiff had engaged the defendant on August 6, 1941. The defendant assured the plaintiff that his arm was all right, despite plaintiff's later allegations that x-rays had caused a cancerous growth in the tissues of his arm. Consultation with the defendant continued until November of 1943. In December of the same year, plaintiff consulted other doctors who informed him of the cancerous condition. The Court specifically noted that, before plaintiff might be chargeable with want of diligence in failing to sooner discover the truth, he must be under a duty to make discovery.

> ". . . where no duty is imposed by law to make inquiry, and where under the circumstances 'a prudent man' would not be put upon inquiry, the

> mere fact that means of knowledge are open and not availed of does not operate to give constructive notice of the facts . . ."
>
> *Bowman v. McPheeters,* supra, 77 C.A.2d at 798.

Even though the continuing relationship was emphasized in *Bowman v. McPheeters,* supra, as affecting discovery under a "fraudulent concealment" rule, the language and rationale of the decision is significant. The Court there recognized that, in the nature of the doctor-patient relationship, so long as the patient continues to look to the doctor for advice, care and treatment, facts, the possession of which might ordinarily put the plaintiff on notice, do not operate to do so. The next logical and inescapable step is that, even though the doctor-patient relationship may gradually come to an end, unless it ends on a note of dissatisfaction or with the possession of some facts which cry aloud the negligence of the doctor, the patient can scarcely be expected to commence his relationship with the next doctor by asking for an investigation of possible negligence on the part of the first doctor.

The opinions in *Billings v. Sisters of Mercy of Idaho,* supra, *Seitz v. Jones,* supra, and the first appellate opinion in this case all cited and relied upon California cases. There are many California cases on point decided later than those referred to. For instance, there are several explaining the importance of the continuation of the doctor-patient relationship. In *Stafford v. Shultz,* 42 Cal. 2d 767, 270 P. 2d 1 (1954),

treatment had commenced on March 6, 1949. It culminated in the amputation of the plaintiff's left leg on September 22, 1949, plaintiff having been informed of the necessity for this amputation on September 2, 1949. On August 2, 1950, the plaintiff received medical reports which had previously been filed with the State Industrial Accident Commission. It was the possession of these reports which led him to the investigation which resulted in suit. The Court applied the usual discovery rule, i.e., that the statute of limitations did not commence to run until the plaintiff had discovered his injuries or, in the exercise of reasonable diligence, *should* have discovered it. Further, the Court specifically noted that, because of the continguing fiduciary relationship between the doctor and the patient, facts which would ordinarily excite suspicion or require investigation did not do so and the same degree of diligence was not required of the plaintiff. Therefore, even though the plaintiff had been told his leg would have to be amputated, he was not put on notice that the cause of this was the defendant's negligence. Neither did the filing of the medical reports with the Industrial Accident Commission, possibly conferring "constructive notice" have this effect. *Stafford v. Shultz,* supra, 42 Cal. 2d at 777, 778 and 782.

Gærlock v. Cole, 199 C.A. 2d 11, 18 Cal. Rptr. 393 (1962) was an appeal from summary judgment. Allegedly, a drug injection undertaken on November 27, 1957, resulted in a permanent deformity. Defendant doctors thereafter represented to plaintiff that

the arm would be all right in a year. The plaintiff returned in a year as directed and was then told that the injury was permanent, but that a "settlement" would be made. In July of 1959, plaintiff learned for the first time from defendants that they intended no settlement. The complaint was filed on August 20, 1959, being governed by a one year statute of limitations. The Court held that the statute had not started to run until the plaintiff discovered that his injury was due to the defendants' wrongful act or reasonably should have discovered this:

> "actual or constructive notice not only of the condition but of its negligent cause and deleterious effect is implicit in this definition . . ."
>
> *Garlock v. Cole,* supra, 199 C.A. 2d at 15.

In the later California cases, the continuation of the doctor-patient relationship is important only insofar as it determines the reasonableness of the plaintiff's conduct. That is, within the context of the discovery rule, the relationship blunts the impact of facts known and prevents knowledge of them from setting the statute running when, in the absence of the relationship, such knowledge would do so.

A series of California cases, applying the discovery rule, in which it was held that the statute had run, is instructive. These cases illustrate the nature and quality of those facts, knowledge of which is sufficient to constitute "discovery". As the Idaho Court in *Billings v. Sisters of Mercy of Idaho,* supra, adopted the discovery rule based largely on California precedent, it is most likely that it would shape and define

this rule in the same fashion, with the same reasoning, as the California precedents.

In cases of negligent misdiagnosis, such as the one at bar, the statute is held to have commenced running when the patient was informed that the original diagnosis was in error. In *Hemmingway v. Waxler,* 128 C.A. 2d 68, 274 P. 2d 699 (1954), the plaintiff's leg was broken in a motorcycle accident on December 31, 1950. X-rays were taken, but the defendant doctors told the plaintiff there was no fracture and that he could put weight on the leg. At some time between January 8 and January 12, 1951, the plaintiff was told by other doctors that his leg was fractured. Suit filed on May 16, 1952, was too late. Once plaintiff was informed that the original diagnosis was in error, the exercise of reasonable diligence required that he now make further inquiry to ascertain the effects of this erroneous diagnosis. *Hemmingway v. Waxler,* supra, 128 C.A. 2d at 71.

In *Mock v. Santa Monica Hospital,* 187 C.A. 2d 57, 9 Cal. Rptr. 555 (1960) surgery was performed on the plaintiff on June 15, 1954. On January 24, 1956, plaintiff was informed, via medical reports, that her present condition was due to the surgery and not to the injury which the surgery had been designed to repair. It was held that the statute of limitations began to run from this date. When the plaintiff had notice or information of circumstances which would put her on inquiry which inquiry, if followed, would lead to knowledge, then the facts were presumptively within her knowledge and her cause of action then

accrued. *Mock v. Santa Monica Hospital,* supra, 187 C.A. 2d at 66.

Another case of misdiagnosis was involved in *DeVault v. Logan,* 223 C.A. 2d 802, 36 Cal. Rptr. 145 (1963). Plaintiff was injured in a fall on February 25, 1960. Defendant told her that she had no fracture and could get around with the use of crutches. On February 26, 1960, she heard a "pop", experienced pain and fainted. Nevertheless, she took no action, although informed there was in fact a fracture, until she heard a chance remark from an attorney that she might have a claim. This occurred in March of 1961 and suit was filed July 26, 1961. Once plaintiff knew the original diagnosis was in error, the statute began to run. Her claim was barred. *DeVault v. Logan,* supra, 223 C.A. 2d at 809.

Weinstock v. Eissler, 224 C.A. 2d 212, 36 Cal. Rptr. 537 (1964) is remarkable chiefly for its recognition that the actual or constructive discovery must be of the *negligence* of the defendant. Plaintiff, not having pleaded the circumstances under which discovery was made or any fact from which it could be concluded that she should not have made earlier discovery, was barred.

Tell v. Taylor, 191 C.A. 2d 266, 12 Cal. Rptr. 648 (1961) was a negligent misdiagnosis case in which the statute of limitations was raised by motion for summary judgment. Plaintiff fell and injured her hip on June 22, 1957. Between that date and July she saw and was treated by defendant on seven occasions. On the 15th of July, an orthopedic surgeon took x-rays

which revealed a fracture and corrective surgery was thereafter performed. Suit was not brought until January 22, 1959. Summary judgment for defendant was affirmed, the Court holding that the statute started to run when the plaintiff acquired full knowledge of the defendant's negligent misdiagnosis on July 15, 1957. *Tell v. Taylor,* supra, 191 C.A. 2d at 271.

The California cases establish the abstract language of the discovery rule, i.e., that the statute starts to run from and the cause of action accrues on the date when the plaintiff actually discovered, or, in the exercise of reasonable diligence should have discovered the negligent injury. In applying the abstract rule to concrete facts, more specifically in the misdiagnosis cases, it is knowledge of the error in the original diagnosis which causes accrual of the cause of action. In this case, no slightest hint of the error in the original pathological diagnosis was received by Appellant until September of 1962. Her complaint was filed well within two years following that date. Applying the discovery rule, her cause of action could have accrued no earlier than September of 1962 and her suit was timely.

The discovery rule has been adopted in many states other than California. In *City of Miami v. Brooks,* Fla., 70 So. 2d 306 (1954) the Court cited and relied upon *Urie v. Thompson,* 337 U.S. 163, 69 S. Ct. 1018, 93 L. Ed. 1282, a much cited case arising under the Federal Employers Liability Act. The statute was held to run from the date when plaintiff had notice of the defendant's negligence:

> ". . . in other words, the statute attaches when there has been notice of an invasion of the legal right of the plaintiff or he has been put on notice of his right to a cause of action . . ."
>
> *City of Miami v. Brooks,* supra, 70 So. 2d at 309.

Louisiana adopted the discovery rule in *Perrin v. Rodriguez,* 153 So. 555 (1934), holding that the prescriptive period did not start to run until the plaintiff discovered that he had sustained injury and that it had resulted from the negligence of the defendant. The same rule was applied in *Thomas v. Lobrano,* La., 76 So. 2d 599 (1954). Two Louisiana cases in which the statute was held to have run are instructive. In *Phelps v. Donaldson,* 243 La. 1118, 150 So. 2d 35 (1963) the plaintiff had, beyond the prescriptive period, become markedly dissatisfied with the defendant's treatment and suspicious of his methods. In *Springer v. Aetna Casualty and Surety Company,* La., 169 So. 2d 171 (1964), a negligent misdiagnosis was the foundation of the law suit. Plaintiff's discovery of the diagnostic error having been beyond the prescriptive period, suit was barred.

Texas has adopted the discovery rule. *Allison v. Blewett,* Tex., 348 S.W. 2d 182 (1961). It was held that plaintiff could rely upon the original statements and diagnosis of defendant doctor until such time as she came into possession of such facts or knowledge as would put an ordinarily prudent person upon inquiry as to their correctness. Once plaintiff was put on notice, the statute of limitations would begin to run. *Allison v. Blewett,* supra, 348 S.W. 2d at 184.

North Carolina, in *Nowell v. Hamilton,* 249 N.C. 523, 107 S.E. 2d 112, was faced with the case of an alleged negligent misreading of x-rays. This misreading had caused plaintiff to submit to needless surgery. Plaintiff advanced a "fraudulent representation" theory, i.e., that the representation as to what the x-rays showed was fraudulent and that the statute of limitations governing fraud cases was applicable. The Court rejected this, adopting the discovery theory. With a three year statute of limitations, the discovery by plaintiff of the error in the reading of the x-rays having come more than three years prior to suit, her law suit was barred.

In *Ayers v. Morgan,* 397 Pa. 282, 154 A. 2d 788 (1959) a case of a surgical sponge left in the patient's body, Pennsylvania appears to have possibly adopted the discovery rule. The majority opinion speaks in terms of continuing negligence, i.e., that there was a continuing negligent breach of the duty to remove the sponge. This negligence continued until the date when the plaintiff learned or should have learned of the presence of this foreign object. The concurring opinion speaks in terms of the pure discovery rule. In *Shaffer v. Larzelere,* 410 Pa. 402, 189 A. 2d 267 (1963) plaintiff, following dismissal, had been denied leave to amend to plead that the negligence was not discovered and could not, in the exercise of reasonable diligence, have been discovered until within the prescriptive period, the defendants having deliberately concealed the facts. The Court held that the amendment should have been allowed. While the proposed amendment spoke in terms of deliberate concealment,

the Court speaks in terms of the statute running only from the date when the complaining party knows, or should have known, of the injury. *Shaffer v. Larzelere,* supra, 189 A. 2d at 270.

New Jersey set forth the standard discovery rule in a foreign object case in *Fernandi v. Strully,* 35 N.J. 434, 173 A. 2d 277 (1961). Significantly, chief reliance was placed upon *Urie v. Thompson,* supra, and the California Court's decision in *Heysman v. Kirsch,* supra.

The Michigan Court, in *Johnson v. Caldwell,* 371 Mich. 368, 123 N.W. 2d 785 (1963) cited and relied upon the California decision in *Greninger v. Fischer,* supra. This is a case of negligent misdiagnosis and plaintiff was not informed of the error in diagnosis until she was hospitalized approximately two years later for an unrelated condition. Suit was filed one year after she was informed of the error in diagnosis and, with a two year statute of limitations, suit was timely. Once more, it was the knowledge of the error in the diagnosis, placing plaintiff upon notice that her condition was the result of the defendant's negligence, which commenced the running of the statutory period.

Spath v. Morrow, 174 Neb. 38, 115 N.W. 2d 581 (1962) was a foreign object case, involving a broken needle left in the patient at the time of suturing following childbirth. With a two year statute of limitations, the plaintiff was informed of the presence of the needle on June 13, 1960 and commenced her action on May 29, 1961. The needle had been embedded in her on July 10, 1951, nearly ten years prior. Holding

that the cause of action did not accrue until the plaintiff discovered, or in the exercise of reasonable diligence should have discovered, the presence of the foreign object, the Court also set forth the philosophy underlying this discovery rule. First, there is a presumption that one having a well-founded claim will not delay in enforcement thereof, but the basis of this presumption is gone when the plaintiff, through ignorance, cannot resort to the Courts. One of the salutary features of the discovery rule is that, since patients should not be encouraged to go from physician to physician in an effort to ascertain whether diagnosis or treatment was proper, the discovery rule requires the plaintiff to act with due diligence based only upon those facts which come to him. *Spath v. Morrow,* supra, 115 N.W. 2d at 584.

A Nebraska Court also has had occasion to deal with a misdiagnosis problem in a case where it was determined that the statute of limitations had run. In *Stacey v. Pantano,* 117 Neb. 694, 131 N.W. 2d 163 (1964), part of the plaintiff's thyroid was removed on June 26, 1959. A condition of faulty calcium metabolism ensued. The defendant assured plaintiff that this was due to her mental or psychological state. On April 6, 1960, the plaintiff consulted another physician and was informed of the error in defendant's diagnosis. The action was brought August 16, 1962, with a two year statute of limitations. The Court rejected the plaintiff's contention that the case was governed by a four year statute of limitations applicable to fraud actions and held that the cause of action accrued on April 6, 1960, when the plaintiff was in-

formed of the error in defendant's diagnosis. Once more, in a misdiagnosis case, similar to that at bar, "discovery" occurs, the cause of action accrues, and the statute of limitations begins to run, when the plaintiff first learns that the original diagnosis was in error. In our case, that date would be September of 1962.

The Federal Courts, in administering the Federal Tort Claims Act, have applied the standard discovery rule to medical malpractice actions. *Quinton v. United States,* 304 F. 2d 234, 5th Cir., 1962; *Hungerford v. United States,* 307 F. 2d 99, 9th Cir. 1962.

In sum, then, the Courts adopting the discovery rule have, whether dealing with foreign object cases or those outside that field, held that the cause of action accrues and the statutory period commences to run only from such time as when the plaintiff actually discovers or, in the exercise of reasonable diligence *should* have discovered the defendant's negligence. Factors such as the continuing relationship of doctor and patient, the difficulty in ascertaining certain wrongs, have been utilized in determining whether, *within the discovery rule,* the plaintiff has exercised due diligence. Appellant's research has uncovered no case, decided by a Court committed to the discovery rule, in which these factors have been utilized to determine whether the discovery rule should be applied. The discovery rule has always been applied, but these factors are a portion of that rule.

In the misdiagnosis cases, it appears uniformly to be held that it is knowledge of the error in the original diagnosis which sets the statute running.

Here, this could be no earlier than September of 1962; Appellant's complaint was filed well within the prescriptive period.

Based upon the above, it is very respectfully submitted that the Trial Court, in applying a standard of when Appellant *could* rather than *should* have discovered the error in diagnosis, erred. Further, there being no contention, no evidence, no claim that Appellant had any notice of the fact that she had not suffered from cancer until September of 1962, her cause of action could have accrued no earlier than that date. As pointed out above, Idaho law makes the statute of limitations in the comparable situation involving discovery of fraud an affirmative defense, as to which the defendant must carry the burden of proof. *Pauley v. Salmon River Lumber Company,* supra. Federal Courts, dealing with motions for summary judgment based upon the statute of limitations where a discovery rule was involved have held that there must neither be a dispute as to the facts nor as to the inferences to be drawn from the facts. See, e.g., *R. J. Reynolds Tobacco Company v. Hudson,* supra, citing and relying upon the Louisiana discovery rule set forth in *Perrin v. Rodriguez,* supra. Cf. *Tracerlab, Inc. v. Industrial Nucleonics Corporation,* supra and *Shects v. Burman,* supra.

Even if the above analysis be incorrect, it is respectfully submitted that the Trial Court erred in applying the standards set forth in the prior appellate opinion in this case. It was clear from the evidence that Appellant continued to rely upon Appellee White as her medical adviser in the field of cancer up to and in-

cluding a time well within the statutory period. The parties stipulated that all medical reports, records, summaries, etc. dealing with this case were still available. Appellee McCarter testified that the tissue section slides were still readable, i.e., he had made a diagnosis from them only a matter of weeks prior to the hearing. It appeared that only one pathologist who had been practicing in the community at the time of Appellant's surgery was no longer available. It is respectfully submitted that this does not show the degree of prejudice to Appellees which could possibly outweigh the policy in favor of giving Appellant her day in Court.

Section 5-230, Idaho Code, provides that a married woman is under a disability to bring a suit during the period of her marriage. Appellant was married at the time of the events upon which this litigation is founded. She continued in her marital state until August of 1959. Section 5-229 provides that the statute of limitations is tolled during the absence of a defendant from the state. Appellee White was absent from the state from September of 1961 on. Thus, Appellant's claim, regardless of the applicability of the "discovery rule", could not have accrued prior to August of 1959. Appellee White's absence from the State tolled the statute of limitations. No evidence was adduced bearing upon the question of whether, considering Appellant's marital status and the absence of Appellee White from the State, an Idaho Court would have determined the filing of the complaint to be timely. Thus, this question is pre-

sented only upon the pleadings and there is a triable issue of fact. Appellant has devoted comparatively little space in this brief to this question solely because it is clear, under the authorities cited above, that the discovery rule operated to delay the accrual of her cause of action until August of 1962.

One possible further issue remains: Although evidence was not offered on the precise point and there appears to have been no argument devoted thereto at trial, it might be argued that the fact that there was no cancerous tissue revealed in the matter stripped away during the radical mastectomy might have placed Appellant on notice that the original diagnosis was in error. The work, *"Cancer: Diagnosis, Treatment and Prognosis"* by Lauren V. Ackerman, M.D. and Juan A. del Regato, M. D., a standard reference work, illustrates the fallacy of any such argument. In this work, it is indicated that, when a biopsy reveals the presence of a malignancy, the only justifiable procedure thereafter is a radical mastectomy. Ibid., pp. 1006 and 1007. Therefore, the radical mastectomy would be required, given malignancy found in the biopsy, whether the radical mastectomy turned up further cancerous tissue or not.

CONCLUSION

It is very respectfully submitted that the District Court erred in the following particulars:

(1) The District Court failed to apply the applicable Idaho rules of law, more particularly those

making the statute of limitations an affirmative defense.

(2) The District Court granted summary judgment despite the presence of disputed issues of fact and of disputed inferences to be drawn from those facts which were not in dispute.

(3) The District Court erred in its conception of the discovery rule, failing to apply the well settled rule that, in a misdiagnosis case, the cause of action accrues only when the patient knows of the error in the original diagnosis.

(4) The District Court erred when, with all medical records available, all of the witnesses alive and able to testify, the tissue slide section available for reading, it found that the prejudice to Appellees outweighed Appellant's right to have her day in Court. For these reasons, it is very respectfully submitted that the judgment rendered below should be reversed and the cause remanded with directions that Appellant be allowed to proceed to trial.

Dated, San Francisco, California,
April 6, 1966.

Respectfully submitted,
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Certificate

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Frederick A. Cone.

No. 20585

In the

United States Court of Appeals For the Ninth Circuit

ANITA T. OWENS,

Appellant,

vs.

RAYMOND WHITE, JOHN C. McCARTER, ALFRED POPMA, and ST. LUKE'S HOSPITAL, a corporation,

Appellees.

BRIEF OF APPELLEE ST. LUKE'S HOSPITAL

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

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In the

United States Court of Appeals For the Ninth Circuit

ANITA T. OWENS,

Appellant,

vs.

RAYMOND WHITE, JOHN C. McCARTER, ALFRED POPMA, and ST. LUKE'S HOSPITAL, a corporation,

Appellees.

BRIEF OF APPELLEE ST. LUKE'S HOSPITAL

On Appeal from the District Court of the United States for the District of Idaho, Southern Division

JURISDICTIONAL STATEMENT

Jurisdiction in the United States District Court for the District of Idaho, Southern Division, was established pursuant to the requirements of 28 U.S.C.A. 1332, upon diversity of citizenship, plaintiff being a resident and citizen of California (T.R. 6), defendant St. Luke's Hospital being an Idaho corporation with principal place of business in Idaho (T.R. 6), defendants Raymond White, John C. McCarter, and Alfred

Popma being residents and citizens of Idaho (T.R. 6), and the amount in controversy, exclusive of interest and costs, exceeding $10,000.00 (T.R. 11-12).

This court has jurisdiction to hear the appeal under provisions of 28 U.S.C.A. 1291 and Rule 73, Federal Rules of Civil Procedure, the appeal being from a final judgment dismissing appellant's complaint.

STATEMENT OF THE CASE

The appellant filed the original complaint in this action on October 14, 1963, seeking to recover judgment against the appellees for damages resulting from their alleged malpractice (T.R. 6-12). The malpractice was alleged to have stemmed from a misdiagnosis occurring during August of 1951 (T.R. 8, 9, 10). On December 30, 1963, the United States Distrct Court for the District of Idaho, Southern Division, granted the appellees' motions to dismiss on the ground that, under the governing Idaho law, the appellant's right to recover was barred by the statute of limitations (T.R. 47-48). The appellant appealed, and on March 12, 1965, this Court reversed the judgment and remanded the cause for further proceedings (T.R. 57, 58-61). The opinion of this Court (*Owens v. White, et al*, 342 F. 2d 817) noted that, while the appeal was pending, the Idaho Supreme Court, in *Billings v. Sister of Mercy of Idaho*, 86 Idaho 485, 389 P. 2d 224 (1964), had aligned itself with jurisdictions holding that statutes of limitations in certain malpractice cases may begin to run when the plantiff knew or, by reasonable diligence, should have known of the alleged negligence. The opinion stated that the question of the application of this theory, generally referred to as the "discovery rule," was a matter of law for the trial court and

should be made the subject of a preliminary inquiry by the court, including the taking of evidence (T.R. 60). At such a hearing, the trial court was to determine whether the patient had such actual or constructive knowledge and, even if she did not, whether a balancing of the equities should permit such a tardy prosecution of the action (T.R. 60).

Pursuant to the foregoing opinion, the District Court, on June 2, 1965, held an evidentiary hearing to determine whether the "discovery rule" should be applied in ascertaining the date of accrual of the appellant's cause of action (T. R. Volume II). Thereafter, on June 22, 1965, the court filed its memorandum decision, including findings of fact and conclusions of law, determining that the "discovery rule" should not be applied in this case (T. R. 117-121). On July 26, 1965, the court filed formal findings, conclusions, and joint order in accordance therewith, at the same time granting the appellant's request to file an amended complaint (T. R. 173-174). The appellees thereafter moved for summary judgment dismissing the amended complaint, and on August 23, 1965, the court heard oral argument on the motions (T.R. Volume III). On September 21, 1965, the motion for summary judgment having been granted, the court filed additional findings of fact and conclusions of law determining that the appellant's amended complaint should be dismissed (T.R. 218-220), and on September 22, 1965, entered its judgment of dismissal with prejudice (T.R. 221-222, 223).

The appellant has now appealed to this Court for the second time, contending that the evidence is legally insufficient to support the findings of fact entered by the court, that the trial court applied an erroneous

legal standard in determining the applicability of the "discovery rule," and that the trial court erred in granting the motions to dismiss (T.R. 232).

STATEMENT OF FACTS

Simply stated, this is a case where the appellant, a skilled nurse with an active interest in the field of cancer, consulted Appellee Dr. Popma during August, 1951, concerning a lump in her left breast; was told first that a biopsy performed by Appellee Dr. White and analyzed by Appellee Dr. McCarter showed no malignancy and then subsequently that it did. She thereupon had the breast removed by Dr. White on August 28, 1951; did virtually nothing for eleven years, and now claims to have discovered during August 1962 that the diagnosis of cancer was incorrect. She filed the instant action in October, 1963, more than twelve years after the diagnosis and surgery complained of, and more than thirteen months after the alleged date of actual discovery. The Idaho statute of limitations provides that actions for personal injury must be brought within two years.

Detailed statements of evidence are set forth in the argument portion of this brief in support of the findings of fact entered by the trial court. However, in order to aid the Court, the following summary is also provided. Citations throughout the brief to the reporter's transcript of the June 2, 1965, hearing (T.R. Volume II) are designated with an "R." Citations to the reporter's transcript of the August 23, 1965 hearing (T.R. Volume III) are designated with "A.R." and citations to the clerk's transcript with "T.R."

The appellant is a college graduate (1948, R. 147) and a registered nurse (since 1943, R. 131, 147) who

has spent most of her adult life in the active practice of nursing, including teaching nursing (R. 108, 109) and supervising the work of other nurses (R. 118, 119). There is a history of malignancies in her family, both her father and an aunt having died from cancer (R. 136, 151). She herself had a special interest in the field, participating for a time in cancer prevention work (R114, 148) and, shortly before the surgery in question, had worked in Salt Lake City, Utah, with a Dr. Wintrobe, who was a leader in the field of malignant blood disorders (R. 103, 155-156). At the time of the surgery she was married, though she obtained a divorce in August, 1959 (T.R. 79-80).

In August of 1951, after moving to Boise, Idaho, the appellant discovered a lump in her left breast (R. 101). She phoned a doctor with whom she had worked in Salt Lake City and asked if he knew anyone she could see in Boise. This doctor referred her to Appellee Popma (R. 101). She then saw Dr. Popma, who examined her and advised her that the lump should be surgically removed, i.e., that a biopsy should be performed (R. 102). Dr. Popma furnished her with a list of three surgeons, including Appellee White. After further inquiries, she went to Dr. White, and the biopsy was performed at St. Luke's Hospital in Boise on or about August 26, 1951 (R. 104).

After the biopsy, the appellant was told by Dr. White that the tissue removed appeared to be nonmalignant (benign) (R. 104, 194). The next day Dr. White phoned her and, according to her testimony, said that there had been a mistake, that they did find some malignant tissue cells, and that she should be in the hospital the following morning (R. 104). A radical mastectomy (removal of the breast and surrounding tissue) was

performed by Appellee White on or about September 1, 1951 (R. 25, 104-105).

After the radical mastectomy, the appellant discussed her situation with Dr. White and was shown a pathological report indicating that no malignancy had been found (R. 116). The surgeon also outlined the follow-up treatment to be pursued, advising that since a pregnancy could activate a malignancy, they would radiate the chest and the ovaries to prevent pregnancy (R. 106). She subsequently underwent this series of radiological treatments, at the Radiology Department at St. Luke's Hospital (R. 107).

In February, 1952, the appellant moved to Pocatello, Idaho, to take a job teaching nursing at Bannock Hospital (R. 108-109). While there she saw her family physician, Dr. Roberts, showed him the surgery, and discussed her case with him (R. 109-110). At one point Dr. Roberts requested her history from Dr. White (R. 36, 189). In the years from 1952 to 1956, she did not see Appellee White, but in 1956 during a trip to Boise, she went to him for a physical examination (R. 112-114). In examining her, he found an enlargement of the thyroid and subsequently performed a thyroidectomy on her at St. Luke's Hospital (R. 112-113, 195).

The appellant testified that she also had physical examinations by Dr. White in 1957, 1958, and 1959, during visits to Boise to attend meetings as a volunteer worker for the American Cancer Society (R. 114-115). Dr. White testified from his records that he last saw her concerning the breast problem in April, 1952, that he saw her in January, 1956, performed a complete physical examination on her in August, 1958, and corresponded with her in 1959 regarding renewal of pre-

scriptions and assistance in locating a physician in California (R. 36, 188-189). Except for the 1956 thyroidectomy, all of the post-1952 consultations and examinations occurred at his private office in Boise, and not at St. Luke's Hosiptal (R. 195).

In 1959, after her divorce, the appellant moved to California, where she went to work for a Veterans Administration Hospital as a staff nurse, later becoming a nursing supervisor (R. 117-118). She testified that she knew "many doctors" in California (R. 121). In April, 1960, she went to Palo Alto to help open a new Veterans Administration Hospital (R. 119). There she became acquainted with a Dr. Shaw, an oncologist, a specialist in cell structures, whom she heard give a lecture concerning detection of breast malignancies (R. 119-120). In 1962 she consulted Dr. Shaw and in August of that year he asked her to sign a consent form so that her prior medical records could be forwarded to him (R. 122). She testified that, after obtaining the records, he called her in and told her that the Stanford Laboratory had read her slides "and that it was their feeling as well as his that I never had had cancer" (R. 123, 125). The instant action was filed, as noted above, in October, 1963, some thirteen months after this consultation.

Appellee White, meanwhile, had ceased his practice of medicine in Boise in May, 1961, and, on September 1, 1961, took a position as director of the Division of Social Economic Activities of the American Medical Association in Chicago (R. 27, 195). However, he maintained his residence in McCall, Idaho, and spent some six weeks each summer in Idaho (R. 196), as well as returning to that state on numerous other occasions during the subsequent years (T.R. 170-171, 177-178).

Appellee St. Luke's Hospital has at all times since August, 1961, and for many years prior thereto, continuously maintained and operated its principal place of business, on a 24-hour-a-day basis, at the same location in Boise, Idaho (T.R. 182, 183-185).

Appellee McCarter testified that since 1951, to the time of the June 2, 1965, hearing, he was in charge of the Pathology Department at St. Luke's Hospital and that in about September, 1962, he had received a letter from Dr. Shaw concerning examination of the slides from the 1951 biopsy performed on the appellant, and indicating the Stanford findings as sclerosing adenosis rather than cancer (R. 78, Exhibit 9).

Dr. McCarter also testified that there had been deterioration of the slides during the fourteen years since they were made, making it more difficult to interpret them. (R. 240, 245-246), that little was known about the narrow field of sclerosing adenosis in 1951, that considerable information about both sclerosing adenosis and other forms of disease of the breast has been developed since that time (R. 241), and that it would be possible to have a case of both sclerosing adenosis and breast cancer (R. 247-248). He could recall no other pathologist who had been practicing in the immediate area in 1951 and was still available (R. 244-245).

There was no evidence that the appellant did anything after the date of the alleged "discovery" beyond consulting an attorney or that either she or her attorney at any time prior to filing of suit gave any notice of claim to any of the appellees.

Nor did the appellant offer any evidence that the

appellee doctors were agents or servants of the appellee hospital, so as to make the hospital liable for any malpractice that might be proved on the part of the doctors. When counsel for this appellee attempted on cross-examination to ascertain the involvement of the hospital, counsel for appellant objected (R. 91, 158, 159, 190, 192).

SUMMARY

1. The District Court properly followed the procedures laid down by the Court of Appeals, and its findings of fact are fully supported by substantial, competent evidence.

2. The court properly determined that the "discovery rule" should not be applied to the instant case and that on a balance of equities, the prejudice to the appellees outweighs the desirability of permitting tardy prosecution of the appellant's cause.

3. The court properly granted summary judgment and dismissed the appellant's complaint in that the statute of limitations was not tolled by her marital status.

4. The suit cannot be saved by the intermittent absence of Appellee White from the state some ten years after the date of surgery.

5. The appellant's thirteen-month delay in filing suit after the alleged actual "discovery" should bar the action even if the discovery rule were otherwise applicable.

6. Dismissal as to Appellee St. Luke's Hospital must be upheld in any event as there was no showing

that the hospital could be liable for any malpractice that might be proved.

ARGUMENT

I

THE EVIDENCE IS LEGALLY SUFFICIENT TO SUPPORT THE FINDINGS OF FACT ENTERED BY THE DISTRICT COURT.

The appellant's initial specification of error is that the evidence is legally insufficient to support the findings of fact entered by the court. Such is manifestly not the case. In fact, each and every one of the findings entered by the court is supported fully by legally sufficient evidence.

Before turning to a discussion of that evidence, however, it is necessary to briefly consider the procedure followed by the District Court. Counsel for appellant contends in his brief (pp. 15-21) that the trial court erred in following the directions of this Court set forth in the opinion reversing and remanding the cause on appeal from the previous dismissal (*Owens v. White, et al, supra* T.R. 58-61). He insists, notwithstanding that opinion, that the applicability of the "discovery rule" should be a question of fact, to be decided by the jury in keeping with the appellant's demand for a jury trial; that as there were issues as to material facts, the motions for summary judgment should have been denied.

This appellee agrees that the usual rule applicable to motions for summary judgment is that allegations of fact in the non-moving party's reply to the motion are to be accepted as true and that where there is a genu-

ine issue of fact, the motion should ordinarily be denied. The instant case, however, did not present a usual or ordinary summary judgment situation. Here the evidence heard and considered by the court in arriving at the findings of fact complained of by the appellant was not in a hearing on motion for summary judgment, but at a unique preliminary "trial within a trial" to determine an issue of law—whether the newly adopted Idaho "discovery rule" should be applied to the instant case. Once that question was answered in the negative, there were no longer any issues of material fact, and the motions for summary judgment were properly granted.

In remanding the cause, the Court of Appeals correctly stated that the law of Idaho, before adoption of the "discovery rule," was that whether a plaintiff's claim has accrued may be a question of law to be determined by the court, citing *Chemung Mining Co. v. Hanley, 9 Idaho* 786, 77 Pac. 226 (1904), (see also *Trimming v. Howard*, 52 Idaho 412, 16 P. 2d 661) for such a question goes to the very existence of the cause of action itself. From that it follows that the same would be true after adoption of the discovery rule. Although the Idaho Supreme Court in its 1964 decision adopting the discovery rule *(Billings v. Sisters of Mercy of Idaho*, 86 Idaho 485, 389 P. 2d 224) did not explicitly state that such determination was to be a preliminary matter, the opinion made it clear that the basic question to be decided was one of law—whether a cause of action had accrued and the statute of limitations had commenced to run.

In his argument that the question of when a cause of action has accrued is one for the jury, counsel for appellant cites the Idaho cases of *Gerlach v. Schultz*, 72

Idaho 507, 244 P. 2d 1095, and *Galvin v. Appleby*, 78 Idaho 457, 305 P. 2d 309. Neither of these cases involved a jury, and neither decision contains anything from which it can be concluded that the existence of cause of action must be a jury question if a jury is demanded. Furthermore, the *Gerlach* case was an action involving fraud, coming within a different statute of limitations which, as noted elsewhere in this brief, provided specifically that such an action would not accrue until discovery of the fraud. In *Galvin*, a contract action, the issue of bar by statute of limitations was raised by demurrer. The Idaho court, as did the trial court here, took evidence (albeit not at a preliminary hearing) and ruled as a matter of law upon the question of when the action accrued. The appellant has cited no Idaho cases, and we have found none, which would in any way preclude the application of the logic of Professor McCormick, cited by this Court, that it is unrealistic to expect a jury to perform the "intellectual gymnastic" of adjudicating both the limitations question and the merits. *McCormick, Evidence*, Section 53 (1954). In fact, as the question is grounded in equity, there could be no right to a jury determination.

Accordingly, this Court suggested to the trial court that the question of applicability of the discovery rule to the instant case should be made the subject of a preliminary inquiry, including the taking of evidence:

> "Whether plaintiff's claim has accrued is a question of law (citing *Chemung*), and like all issues of law must be resolved by the court even though this will require evidence; in other words, the issue presents a preliminary matter for the court, rather than the jury, since it does not reach the merits of the claim but instead involves the very existence of the claim itself . . ."

It then, again placing itself in the eyes of the Idaho Supreme Court, suggested that application of the discovery rule should be tempered by equitable considerations, in effect saying that the trial court should hear and consider even conflicting evidence and weigh the equities to reach its determination:

> ". . . we deem it appropriate to add the following caveat: Consistent with the prominence given to the policy underlying statutes of limitations in *Billings*, *supra*, we believe the Idaho court would temper application of the discovery doctrine by hedging it with equitable considerations. To illustrate, courts in other states that have applied the discovery doctrine to non-foreign object cases have emphasized factors such as the 'continuing relationship' between doctor and patient as a reason for applying the rule. (Citations) This suggests, in our estimation, that the discovery doctrine is itself subject to some restraint as the time from the occurrence of the malpractice grows greater. In such circumstances, the considerations of fairness to the defendant underlying statutes of limitation become more insistent, while the plaintiff's appeals to equity implicit in the discovery doctrine become less so. We believe the Idaho courts would apply a concept akin to the equitable doctrine of laches to limit the discovery rule, a rule which itself has its genesis in equity. Thus the suit of a plaintiff who is reasonably diligent may be barred if the defendant shows undue prejudice because of an extreme lapse of time between the commission of the wrongful act and the commencement of suit. To so conclude strikes us as a reasonable accommodation between the competing considerations noted in *Billings* of giving full scope to the statute of limitations

on the one hand and according a reasonable measure of justice to the plaintiff on the other."

To make it even more clear that court should weigh all the evidence bearing upon the point, the decision noted that:

"Factors which might be considered in making such a determination would be illustrated by but not limited to: the nature of the alleged injury, the relative difficulty of proving the wrong as contrasted with rebutting the proof, the availability of witnesses and records, the existence of a continuing relationship between doctor and patient, and the inherent difficulty of discovering certain wrongs."

Thus it is clear that the trial court was to sit as a trier of fact for this preliminary matter and, from its findings of fact therefrom, to enter its conclusions of law on the question of whether the discovery rule should be applied. That is exactly what the court did. It complied fully and precisely with the directions of the appelate decision, and its procedure must be upheld.

It should be noted that if counsel for the appellant had really believed that the opinion of this Court in *Owens v. White, et al* was wrong, he could and should have petitioned for rehearing and pointed out the alleged errors. Having not done so, that opinion stands as the law of the case, and the trial court was required to follow it. That court then properly considered the subsequent motions for summary judgment of dismissal as it would have done in any case so standing.

It should also be noted that to the extent that counsel for appellant contends the matters should have been raised by answer, the record is clear that trial counsel

was given an opportunity by the court to stand on such a position and declined to do so (A.R. 18-19). In addition, he has failed to object to Finding No. II of the Court's Findings of Fact and Conclusions of Law of September 21, 1965 (T.R. 219), which is as follows:

> "At the said hearing of August 23, 1965, counsel for the plaintiff stipulated that the Motion for Summary Judgment was properly before the court and directed to the plaintiff's Amended Complaint, waiving the objection that an Amended Answer to the Complaint, or in the alternative, a Motion raising the Statute of Limitations, had not been made."

Turning now to the appellant's contention that the court's findings of fact are not supported by sufficient evidence, it is clear that with regard to the June 2, 1965 evidentiary hearing the District Court was sitting as a trier of fact just as it would in a trial to the court on the merits. Thus it was bound to decide the issue on a preponderance of the evidence.

The issue was whether, in effect, there could be a claim constituting a cause of action, and, as stated by this Court in the remanding opinion, "the burden of establishing a claim rests upon the plaintiff" (T.R. 60).

Thus, the findings of the court must be reviewed according to the usual rules for review of findings by a tier of fact, and subject to the usual presumption of correctness. The general rule is well stated in 3 Am. Jur., Appeal and Error, Section 896, pp. 458-461, as follows:

> "Superior appellate courts are, primarly, constituted for the purpose of dealing with questions of law; the consideration of any question of fact by such a court

involves a decision on the record without any opportunity being afforded for judging as to the credibility of witnesses except insofar as discrepancies may appear in the testimony in the record. The trial court is naturally in a better position to pass on the credibility of the witnesses, and the appellate court will not, in fact, generally speaking, cannot, set itself up as a judge of the credibility of witnesses, or weigh the evidence, even though a preponderance of it against the finding or verdict is apparent. The question of credibility of witnesses and the weight to be given their testimony is exclusively within the province of the trial court; the province of the appellate court is to determine whether there is any evidence from which the trial court might properly have drawn its conclusion. As has been pointed out, discrepancies are more likely to appear in the record of the testimony of a candid witness than in that of an astute perjurer. These considerations have led the appellate courts to deal with findings of fact made by the trial judge, especially upon oral testimony of witnesses, where he has had full opportunity to observe the demeanor of the witnesses and judge their veracity, in much the same manner as they would with the verdict of a jury, according to such findings the same conclusiveness and binding effect, or the same weight, as a verdict of a jury would have been accorded had one been rendered. They will not as a general rule be disturbed by the appellant court unless they are clearly contrary to, or plainly, flagrantly, or indisputably against, the evidence, or are so clearly contrary to the preponderance of the evidence as to produce in the minds of the reviewers a conviction amounting to a reasonable certainty that they are wrong. These findings should not be disturbed or

modified by an appellate court unless an obvious error has intervened in the application of the law, or some grave mistake has been made in the consideration of the facts, or unless they are in conflict with the settled rules of logic and reason and contrary to what any reasonable mind would find. They will not be disturbed unless a mistake of judgment is apparent, or unless they are plainly and clearly wrong, and cannot be supported on any rational view of the testimony. If a judicial mind could, on due consideration of the evidence as a whole, reasonably have reached the conclusion of the court below, the findings must be allowed to stand. Such findings will not be disturbed when supported or sustained by competent evidence, especially where the evidence is conflicting or where different inferences can reasonably be drawn therefrom. In such cases the conclusion of law only is reviewable."

The Idaho Supreme Court has made it clear that it will not disturb the findings made by the trier of fact if those findings are supported by any substantial and competent evidence, no matter how meager the evidence may be. In *Watkins v. Watkins*, 76 Idaho 316, 281 P. 2d 1057, the court put it this way, at p. 325:

"The findings made by the trier of facts, supported by substantial, competent though conflicting evidence, however meager, will not be disturbed on appeal. (Citations)"

In *Smith v. Clearwter County*, 65 Idaho 271, 143 P. 2d 561, the court stated, at pages 277-278:

". . . This court is committed to the rule that findings supported by substantial evidence (are) controlling on appeal, and that where there is sufficient compe-

tent evidence, if uncontradicted, to support (the) findings, the findings will not be disturbed. (Citations) Furthermore, this court has universally held that where the facts 'might very well lead different minds to reaching different conclusions upon the issues presented; and where such is the case, however meager the evidence, if it is of a substantial nature and character, the findings of the triers of fact should prevail.' "

In *Angleton v. Angleton*, 84 Idaho 184, 370 P. 2d 788, it was said, at p. 198:

"Moreover the trial court, not this court on appeal, resolves the conflicting evidence and determines the weight, credibility and inferences to be drawn from such evidence. (Citations) That the trial court could have viewed the facts differently, or that we might perhaps have done so, if we had been the initial trier thereof, does not alone entitle us to reverse the case. Under the mandate of Rule 52 I.R.C.P., a reviewing court is to accept the trial court's findings of fact *unless clearly erroneous*, and if conflicting inferences may be drawn from the established facts, it is not within the province of the appellate court to substitute its judgment for that of the trail court."

And, again, in *Conley v. Amalgamated Sugar Co.*, 74 Idaho 416, 263 P. 2d 705, at p. 424:

"After the court has found, the criteria are not what other or different findings the evidence could or would sustain, not what findings are plausible, not the weight or quality of the evidence or credibility of witnesses, but the sole criterion is simply whether there is substantial evidence, regardless of conflict, to sustain the findings as made, with all

reasonable inferences and intendments in favor thereof. This proposition is so universal, so oft repeated and adhered to as to need no citation of authority in support thereof. It is not what evidence tends to support appellant, or negative that favorable to respondents, but it is what evidence tends to support respondents, with all reasonable inferences and intendments to be drawn in favor of respondents, which controls the determination of the controversy in this court."

To the same effect, see *In re Randall's Estate*, 58 Idaho 143, 70 P. 2d 389; *Nelson v. Altizer*, 65 Idaho 428, 144 P. 2d 1009; *Chatterton v. Luker*, 66 Idaho 242, 158 P. 2d 809; *Loosli v. Heseman*, 66 Idaho 469, 162 P. 2d 469; *Jackson v. Blue Flame Gas. Co.*, ____ Idaho ____ 412 P. 2d ____.

Here the evidence supporting the findings of the court is far more than meager. In every instance there is substantial, competent evidence, and as to many of the findings it is virtually uncontradicted.

The court's Finding No. 1 is as follows:

"That the plaintiff was, for a number of years, prior to the surgery, a registered nurse, actively pursuing her profession, and was a college graduate with a degree of Bachelor of Science in that field." (T.R. 118.)

The appellant herself testified that she received three years of nurses' training at Good Samaritan Hospital in Portland, Oregon, becoming a registered nurse in 1943 (R. 131, 147), that she received a bachelor of science degree in education from the University of Utah in 1948 (R. 100, 147), and that she continued her training by attending a workshop at the University

of Colorado in 1955 (R. 149) and by attending Wayne University in Detroit (R. 149). She further testified that she was a nurse in the Army in 1943 and 1944 (R. 150) and that she worked as a nurse in Salt Lake City from 1947 to 1949 (R. 100). Such is clearly substantial, competent and uncontradicted evidence.

Counsel for appellant quibbles with the finding that the appellant's' degree was "in that field," when she testified that it was a degree in education. It should be noted, however, that her testimony was that she got the degree in order to teach nursing (R 147) and that she received some 45 hours of credit toward the degree for her nurses' training (R. 147). Surely this means substantially that the degree was in the general field of nursing.

Finding No. 2 is as follows:

> "That she remained, during all of the time after the surgery, actively in the nursing profession, working in hospitals, and was also active in cancer prevention work." (T.R. 118.)

Again, the pertinent evidence is from the appellant's own uncontradicted testimony. In February, 1952, immediately after release from her post-surgery treatment, she returned to Pocatello, Idaho, where she went to work at Bannock Memorial Hospital (R. 109). Sometime before 1956 she joined her husband in Montana for a year, but returned to Malad, Idaho, where she worked with the American Cancer Society in a cancer prevention program during 1956, 1957, and 1958 (R. 114, 148). In 1955 she took special training at Wayne University in Detroit (R. 149), and in 1959, she went to California, where she continued to work as a nurse and nursing supervisor in Veterans Adminis-

tration hospitals up to the date of the hearing (R. 116, 118).

Although perhaps the record does not account for her entire time since the surgery, it is clear that she continued to be active within the profession, including the stated types of activity. In fact, at one point during her testimony, the following appears:

"Q. You have, however, been actively involved as a nurse employed in a hospital during these many years, have you not?

"A. Yes." (R. 154).

In short, the evidence is more than ample to support the finding.

Finding No. 3 is as follows:

"That the plaintiff was originally advised, prior to the surgery, that the lump in her left breast was benign. One or two days after the plaintiff was so advised, a defendant called her by phone, to inform her that an error had been made and that the tissue was malignant, in that it was cancerous." (T.R. 118.)

Again the appellant's own testimony was in clear support of the finding, as follows:

"A. He said, 'You are a lucky girl. It is benign. You can go home,' and so I got up and went home.

"Q. When was the next time you heard from Dr. White?

"A. The next day, I believe about dinnertime. He called me and said that there had been a mistake and that they did find some malignant tissue cells and I should be in the hospital the next morning." (R. 104)

Finding No. 4 is as follows:

> "That after the surgery, plaintiff was advised by the defendant, Dr. White, that the excised flesh contained no malignant cells, and that all of the malignacy had been in the tissue removed in the biopsy which was performed prior to the surgery." (T.R. 118.)

The appellant's testimony, in answer to a question by her own counsel, was that she was told by Dr. White after the surgery, "I think we got it all" (in obvious reference to the biopsy) and that (from the surgery) they hadn't found any malignancy (R. 116). She said he even showed her the pathology report to reassure her (R. 116) and she understood it (R. 152). Again, this is clearly ample to support the finding.

Finding No. 5 is:

> "That the plaintiff professed to be conscious and worried, at all times after the surgery, of the possibility of a recurrence of development of cancerous cells in her body." (T. R. 118-119.)

The appellant testified that immediately after the surgery she was apprehensive and "wanted to know if it was a little amount or a big amount" (R. 116), that she was "concerned about whether I was going to live or die" (R. 106), that she kept getting complete physicals for reassurance (R. 112-113, 115), that she knew that in cancer talk "they don't say you are cured, they say you are at a five year survival or a 10 year survival—and I was at eight year survival . . ." (R. 117), that she checked with Dr. White in 1959 to see if it was foolhardy to go to California and work (R. 117), that she was cancer conscious because of the death of her

father and aunt from cancer (P. 136), and that "there are a lot of things about cancer that you kind of lean on your doctor" (R. 113). Surely this plainly paints a picture of a woman acutely conscious of the possible recurrence of a cancer and fully supports the finding of the court.

Finding No. 6 is:

"That plaintiff knew at all times that great improvements were being made in the diagnosis and detection of cancer in the human body. She worked, through the years after the surgery, in hospitals where laboratories were maintained and pathologists retained." (T.R. 119).

As noted above, the appellant testified that she worked for several years with the American Cancer Society in a program of public education, including the subject of breast cancer (R. 148) and that she worked in various hospitals as a nurse, supervisor and instructor in the years after the surgery. She further testified that while she was working at the Veterans Administration Hosiptal in California, she knew "there were many research things going on" (R. 119), that she had never worked in a hospital the size of Appellee St. Luke's in Boise that did not have a pathologist on its staff (R. 130), and that she understood the mission of a pathologist (R. 131-132). The evidence is sufficient to support the finding.

Finding No. 7 is:

"That plaintiff knew at all times that the defendant hospital records and the slides on which the diagnosis was predicated were available for examination at her simple request." (T.R. 119).

The correctness of this finding is abundantly clear. The appellant testified that such was the fact (R. 160), and her trial counsel stipulated that such records would have been available to any recognized physician or hospital at any time upon request (R. 236).

Finding No. 8 is:

> "For a period of eleven years from the date of the surgery she made no investigation to determine the accuracy of the diagnosis on which the surgery was based." (T.R. 119.)

Again, the appellant testified that she made no investigation of any kind until the Shaw lecture in 1962 (R. 143). Thus the finding must be affirmed.

Finding No. 9 is:

> "That twelve years elapsed between the date of surgery and the date suit was filed." (T.R. 119.)

The date of surgery, according to the testimony of Dr. White, was September 1, 1951 (R. 25). The appellant placed the date at August 28, 1951 (R. 104-105). The complaint was filed in October 14, 1963 (T.R. 6). The finding must stand.

Finding No. 10 is:

> "That the tissue samples on which diagnosis was had were originally treated and placed on slides, which slides are now deteriorated to some degree." (T.R. 119.)

Appellee McCarter, under whose supervision the slides were prepared and under whose custody they remained, testified at length as to how the slides were

made and that they had deteriorated to a degree since they were made (R. 240, 246, 248-253). As to counsel for appellant's contention that a diagnosis was possible, the doctor testified that they were readable, but "in the same sense that you could read an old book in poor light" (R. 257). The finding is clearly supported by sufficient evidence.

Finding No. 11 is:

> "That evidence as to the standard of care and competence ordinarily exercised by physicians, especially pathologists in the detection and diagnosis of cancer, in the Boise, Idaho, area, in the year 1951, will be most difficult to procure." (T.R. 119.)

Appellee McCarter testified, without contradiction, that so far as he knew, no other pathologist who was practicing in the Boise area in 1951 is still available (R. 243, 245). A Dr. Carl in Twin Falls, Idaho, is about the same age as Dr. McCarter and had the same period of schooling, but he was not in Idaho in 1951 and did not come to the state until two or three years before the hearing (R. 243, 244). In the meantime, since 1951, there has been considerable development with regard to diagnostic practices and techniques within this field (R. 241) and, as would have been clear even without testimony, it would be difficult to remember details as far back as 1951 (R. 242). The finding must be affirmed.

Finding No. 12, the final finding from the June 2 hearing, is:

> "That while the plaintiff sometimes sought out the defendant, Dr. White, for medical attention, during the years after her surgery, she also saw and con-

sulted other physicians and did not rely solely on Dr. White for medical advice and treatment. That the plaintiff had not lived in the community or general vicinity of Boise, Idaho, from the date of surgery until the present time. That there was not a continuing relationship of doctor and patient after the post-operative surgery and treatment in the usual sense between the plaintiff and the defendants." (T.R. 119-120.)

The appellant testified on several occasions to the effect that Dr. Roberts in Pocatello had been her family physician for all her life (R. 102, 140), that even on the day of the surgery she had Dr. White call Dr. Roberts (R. 140), that Dr. White was in communication with Dr. Roberts "simultaneously whenever I was Dr. White's patient" (R. 140), and that she saw Dr. Roberts on occasions after the surgery (R. 110, 139). Furthermore, she testified that she "knew" many doctors in California (R. 121). Appellee White testified from his records (which appellant confirmed that he kept, R. 115) that he last saw her concerning the breast problem in April, 1952, that he saw her in January, 1956, in connection with the thyroidectomy, that he performed a physical examination on her in August, 1956, and corresponded with her in 1959 (R. 188-189). The correspondence was in part in response to her request that he assist her in locating a physician in California (R. 36, 189). In June, 1956, Dr. White was asked by Dr. Roberts to forward the appellant's medical history to him in Pocatello (R. 36, 189).

It is manifest from the record that the appellant left the Boise area soon after the surgery complained of (R. 108-109) and returned only for visits and for the

thyroidectomy in 1956 (R. 112-115). In 1959, she moved to California (R. 117).

Thus the evidence is fully sufficient to support the finding.

The proposed findings of fact detailed by counsel for appellant on pages 23 to 29 of his brief are in some cases mere quibbles with details in wording of the court's findings. In other instances they are clearly contrary to the findings adopted by the court in its wisdom and, as noted above, fully supported by sufficient evidence. At any rate, as it was put by the Idaho Supreme Court in *Conley v. Amalgamated Sugar Co.*, *supra*, p. 424:

> " . . . The criteria are not what other or different findings the evidence could or would sustain, not what findings are plausible, not the weight or quality of the evidence or credibility of witnesses, but the sole criterion is simply whether there is substantial evidence, regardless of conflict, to sustain the findings as made, with all reasonable inferences and intendments in favor thereof.

That criterion has been fully met in the present case, and the findings of fact made by the court must be affirmed.

II

THE TRIAL COURT PROPERLY APPLIED THE DIRECTIONS OF THIS COURT IN DETERMINING THE APPLICABILITY OF THE DISCOVERY RULE AND PROPERLY CONCLUDED THAT THE RULE SHOULD NOT BE APPLIED.

As the trial court so well stated, in its Memorandum Decision of June 22, 1965:

> "That this case is such a stale one as the Statute of Limitations generally bars cannot be doubted." (T. R. 117.)

The Idaho statutes involved, I. C. Sections 5-201 and 5-219, state simply:

> "5-201. *Limitations in general.*—Civil actions can only be commenced within the periods prescribed in this chapter after the cause of action shall have accrued, * * *"
>
> "5-219. *Actions against offices, for penalties, on bonds, and for personal injuries*—Within two years:
>
> * * *
>
> "4. An action to recover damages for an injury to the person, or for the death of one caused by the wrongful act or neglect of another.
>
> * * *"

Here the alleged negligence and malpractice occurred in August and September of 1951. The complaint was not filed until October of 1963—more than twelve years later!

As we read the opinion of this Court in *Owens v. White, et al supra*, the trial court's original dismissal was reversed and the cause remanded solely because of adoption by the Idaho Supreme Court, after the appeal, of the so-called "discovery rule." That court, in the decision in point *(Billings v. Sisters of Mercy of Idaho, supra)*, stated the rule as follows, 86 Idaho at 497-498:

> "We will, therefore, adhere to the following rule: where a foreign object is negligently left in a pati-

ent's body by a surgeon and the patient is in ignorance of the fact, and consequently of his right of action for malpractice, the cause of action does not accrue until the patient learns of, or in the exercise of reasonable care and diligence should have learned of the presence of such foreign object in his body."

This Court, in its wisdom, concluded that Idaho would invoke the same rule in a misdiagnosis case and remanded the cause to the District Court for a determination of whether the rule should be applied to the instant case and, thus, whether the appellant's claim had accrued. This issue, it said, is a question of law that

"must be resolved by the court even though this will require evidence; in other words, the issue presents a preliminary matter for the court, rather than the jury, since it does not reach the merits of the claim but instead involves the very existence of the claim itself." (T.R. 60.)

As noted above, the author of the decision, Judge Koelsch, laid down in detail certain guidelines to be followed by the District Court in its determination:

"In sum, we hold that the discovery rule may be invoked in this case, and whether it is to be applied is a preliminary legal question for the court to determine. This conclusion requires that the judgment be reversed and the cause remanded. Accordingly, we deem it appropriate to add the following caveat: consistent with the prominence given to the policy underlying statutes of limitations in *Billings*, supra, we believe the Idaho court would temper application of the discovery doctrine by hedging it with equitable considerations. To illustrate, courts in other states that have applied the discovery doctrine to non-

foreign object cases have emphasized factors such as the 'continuing relationship' between doctor and patient as a reason for applying the rule. (Citations) This suggests, in our estimation, that the discovery doctrine is itself subject to some restraint as the time from the occurrence of the malpractice grows greater. In such circumstances, the considerations of fairness to the defendant underlying statutes of limitation become more insistent, while the plaintiff's appeals to equity implicit in the discovery doctrine become less so. We believe the Idaho courts would apply a concept akin to the equitable doctrine of laches to limit the discovery rule, a rule which itself has its genesis in equity. Thus, the suit of a plaintiff who is reasonably diligent may be barred if the defendant shows undue projudice because of an extreme lapse of time between the commission of the wrongful act and the commencement of suit. To so conclude strikes us as a reasonable accommodation between the competing considerations noted in *Billings* of giving full scope to the statute of limitations on the one hand and according a reasonable measure of justice to the plaintiff on the other.

"Factors which might be considered in making such a determination would be illustrated by but not limited to: the nature of the alleged injury, the relative difficulty of proving the wrong as contrasted with rebutting that proof, the availability of witnesses and records, the existence of a continuing relationship between doctor and patient, and the inherent difficult of discovering certain wrongs."

It is manifest from the record and from the findings of fact entered by the court, discussed in the previous section of this brief, that the trial judge did just as

this Court suggested he do. He heard a very long day of testimony on every facet of the issue involved. He then made his findings of fact, including specific findings on all of the particular factors suggested in Judge Koelsch's opinion, weighed the equities, and concluded as a matter of law that the discovery rule should not be applied in the instant case (T.R. 116-120).

Counsel for appellant devotes a large portion of his brief to the fact that the court concluded that the appellant "could have, by exercise of due diligence, discovered the alleged malpractice at any time after the surgery and treatment complained of" (T.R. 120) rather than that she *should* have done so. He cites numerous cases to the effect that the discovery rule as applied in jurisdictions invoking it requires a showing that a plaintiff "should" have discovered the malpractice before the cause of action will be said to have accrued.

We are aware, as without doubt was the court, that the discovery rule decisions generally use the word "should." But to bring an appeal upon the difference and to base thereon a contention that the court applied an erroneous legal standard in its determination is, we think, again mere quibbling. There is frequently little to be gained by trying to speculate as to why a particular word has been used instead of another in a given situation. However, it can be noted here that the word "could" is the same word used by the appellant in the pertinent allegations, both in the original complaint (Paragraph IX, T.R. 8) and in the amended complaint (Paragraph IX, T.R. 125) filed by leave of the court after the discovery rule hearing.

It is clear from an analysis of the discovery rule itself that the findings here support a conclusion

phrased with either "could" or "should." As stated by the Idaho court in *Billings*, and noted by this Court in the opinion by Judge Koelsch, the underlying theme in all such cases is a conflict between the policy of discouraging the fostering of stale claims and the policy of allowing meritorious claimants an opportunity to present their claims (86 Idaho at 489). Thus the crucial portion of the rule is not the difference between "could" and "should," but the presence or absence of "due diligence" such as to weight the equities in favor of allowing the plaintiff to present the claim. The trial court found that the appellant knew that all the evidence of the alleged malpractice was available to her at all times after the acts complained of and that she did nothing for approximately eleven years to discover any wrong. He then concluded in effect, that under the circumstances, had she exercised the "due diligence" required by the law she "could," "should," or even "would" have discovered the malpractice, if any there be, at any time after the surgery. That conclusion, however phrased, must be upheld.

It cannot be emphasized too strongly, that the appellant is not an ordinary plaintiff. She is not the typical medical patient, unschooled and unknowledgeable in medical matters, who must of necessity rely in almost blind faith in what she is told of matters she can't begin to comprehend. As detailed in the discussion of the findings of fact, this appellant is a highly trained, skilled nurse who has maintained her standing as an active member of her profession. She professed to be conscious and worried, at all times after the surgery, of the possibility of a recurrence of cancerous cells in her body (Findings of Fact No. 5, T.R. 118-119). She was active in cancer prevention work (Finding of Fact No. 2, T.R. 118). She even described herself as "cancer-

wise" (R. 103) and "cancer conscious" (R. 135). She knew at all times that great improvements were being made in the diagnosis and detection of cancer in the human body and worked, through the years, in hospitals where laboratories were maintained and pathologists retained (Finding of Fact No. 6, T.R. 119). She knew at all times that the hospital records and the slides on which the diagnosis was predicated were available for examination at her simple request (Finding of Fact No. 7, T.R. 119). She testified that she was aware of the role of the pathologist in diagnosis (R. 131-132) and that she realized that his diagnosis was but an opinion (R. 132, 155). As a nurse she would know that there might be differences of opinion as to diagnosis. Yet, for eleven years, she did nothing by way of investigation to determine the accuracy of the diagnosis on which the surgery was based (Finding of Fact No. 8, T.R. 119).

Add to these the fact that she had notice even before the surgery that there had been inconsistent diagnoses. This is not a case where she was given no clue that a mistake might occur. Rather, she was told by the surgeon immediately after the biopsy that the lump from her breast was benign and then a day or two later that *an error had been made* and that the tissue was malignant, in that it was cancerous (Finding of Fact No. 3, T.R. 118). To even a layman, let alone a medically experienced person, this should have been a red flag—particularly when the surgeon advised her after the "radical" that no further malignant cells had been found (Finding of Fact No. 4, T.R. 118). She had constant notice that the diagnosis might be wrong, but she ignored it. She let years pass during which conditions changed; yet she made no effort to discover

whether her rights had been violated. Such is plainly not due diligence.

The findings noted above should be sufficient alone to support the conclusions of the court. Yet there is more, too. Here there was not the type of continuing doctor and patient relationship noted in Judge Koelsch's opinion and in many of the cases cited by counsel for appellant (Finding of Fact No. 12, T.R. 119-120). Nor was there absence of undue prejudice to appellees because of the extreme lapse of time between the commission of the alleged wrongful acts and the commencement of suit. To the contrary—the evidence has grown stale, the slides containing the tissue samples from which diagnosis was had have deteriorated to some degree (Finding of Fact No. 11, T.R. 119), and it would be most difficult to procure any evidence as to the standard of care and competence ordinarily exercised by physicians, especially pathologists, in the detection and diagnosis of cancer, in the Boise, Idaho, area, in the year 1951 (Finding of Fact No. 12, T.R. 119).

Counsel for appellant, at pages 28 and 29 of his brief, contends that the case of *Gerlach v. Schultz*, 72 Idaho 507, 244 P. 2d 1095, is analogous to the case at bar and would indicate that availability of certain facts, even when contained in recorded documents, does not mean that a party is charged with the duty of discovering them. What he fails to note is that that was a case of fraud, governed by a different statute. The statute there, I. C. Section 5-218, provided:

> "* * *
>
> "4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued *until the discovery*, by the aggrieved party, of the facts constituting the fraud or mistake." (Emphasis added)

Here the statutes does not require discovery, nor does the opinion of the Idaho court in *Billings*, or the opinion of this Court, or the discovery rule itself. What is required in order to justify a tardy claim is a showing of due diligence sufficient to justify equitable relief against potential prejudice to the defendents. After all is said and done, the statute of limitations is still a part of the law of Idaho. This Court's decision did not erase it, but merely said that the appellant should have the opportunity to show why she could not, or should not, have discovered her claim promptly. This she has failed to do.

In sum, when the facts are appraised and the equities weighed, as was noted in *Billings* and as suggested in the opinion of this Court, it is apparent that the decision should be as it was—that the discovery rule should not be applied to the instant case. This was no hasty decision; the trial court devoted a great deal of time and study to the problems at hand (A.R. 20). It properly followed the guidelines set down by the Circuit Court, in line with the thoughts and philosophies of the only Idaho decision available. The conclusions it reached are fully supported by its findings of fact, and its determination must be affirmed.

III

THE TRIAL COURT PROPERLY DISMISSED THE APPELLANT'S COMPLAINT IN THAT THE STATUTE OF LIMITATIONS WAS NOT TOLLED BY THE FACT SHE WAS A MARRIED WOMAN.

With the court's determination that the discovery rule should not be applied to the instant case—that her

case of action, if any, "accrued" upon the occurrence of the acts complained of, it follows logically that the action is barred by Section 5-219 of the Idaho Code in that it was filed more than two years after it accrued. However, counsel for appellant has raised another contention—that Section 5-230 of the Idaho Code provides that a married woman is under a disability to bring a suit during the period of her marriage and that the appellant was married at the time of the alleged malpractice and until August of 1959, or as the court found (T.R. 219), on or about September 1, 1959. Subsequent to that, he contends, the statute was tolled again by the absence of Dr. White.

Looking first to the question of the inability of a married woman to bring a cause of action, the trail court concluded, in dismissing the complaint, that the appellant's marital status did not toll the running of the statute of limitations (T.R. 220). This conclusion must be affirmed.

Section 5-230 of the Idaho Code provides as follows:

> "If a person entitled to bring an action, other than for the recovery of real property, be, at the time the cause of action accrued, either: . . .
>
> "A married woman, and her husband be a necessary party with her in commencing such action;
>
> "The time of such disability is not a part of the time limited for the commencement of the action."

If a woman had no legal capacity to commence an action by herself, without her husband, and thus stopped the statute of limitations from running, it would obviously be unfair to allow the statute to run against her while she was so handicapped. The above statute was designed to toll the statute of limitations while such a disability existed.

However, in Idaho a married woman has capacity to commence an action in her own name alone for recovery of personal injury damages. Her husband is not "a necessary party with her in commencing such action" and the above statute has no application. The Idaho case directly in point is *Muir v. The City of Pocatello*, 36 Idaho 532, 212 Pac. 345 (1922).

In *Muir*, the plaintiff was injured in a fall on a city side walk. She commenced suit in her own name within the statutory period in February, 1918. After the statute of limitations had run, defendants moved to strike the complaint on the grounds that the husband was a necessary party plaintiff. The court permitted the plaintiff to amend, adding the husband, and defense demurred to the complaint on the grounds that the action was barred by the statute of limitations. The court held that the wife had effectively commenced the action in her own name before the statute of limitations had run, and that the amendment did not set forth a new cause of action. In discussing the issue, the court noted that the question in that form had never been presented to the Idaho Supreme Court, then stated, at pages 539-540, rest in other jurisdictions:

> ". . . the weight of authority and perhaps the better reason sustain the view that a married woman has such an interest in a cause of action for injuries to her person or character that she should be permitted to maintain actions of this kind, although her husband is a proper or even necessary party, in order to render the judgment res adjudicata against both members of the marital community. It may be questioned whether one of this class of citizens, now fully emancipated under the federal constitution as citizens of the United States, can be deprived of this right solely because of her being a married woman,

without denying rights and immunities granted by fundamental law, when other citizens have such rights, particularly in view of C.S., Sec. 6637, which provides that: 'A woman may while married sue and be sued in the same manner as if she were single etc.'

"However this may be, the trend of modern legislation and also of judicial decisions is toward recognizing the right of a married woman to sue alone for personal injuries to herself. California, by the amendment of 1913, now permits her to maintain this action without joining her husband, but prior to this, by a long line of decisions, it was always held under statutes similar to our own that she was a necessary party. The Idaho legislature, L. 1915, page 187, added to C.S., sec. 4666, following the clause which gives the husband the management and control of the community property, these words: 'Except the earnings of the wife for her personal services, and the rents and profits of her separate estate.' If a married woman has a right to maintain an action to recover for her personal services, she certainly should not be denied the right to maintain an action for an injury to her person or character. In *Chicago, B. & Q. Ry. Co. v. Dunn*, 52 Ill. 260, 4 Am.Rep. 606, in a jurisdiction where most of the common-law disabilities of married women then prevailed, Breese, C. J., said: 'A right to sue for an injury is a right of action —it is a thing in action and is property. (Kent Com. 432.) Who is the natural owner of the right? Not the husband, because the injury did not accrue to him; it was wholly personal to the wife; it was her body that was bruised; it was she who suffered the agonizing mental and physical pain.'

"If a married woman has such an interest in an action for injuries to her person or character that she

may maintain an action therefor, even though her husband is a proper party, it would follow that her commencing such an action within the limitation period will toll or suspend the running of the statute so that the bringing in of the husband as a party after the lapes of this period would not be the substitution of a new or different cause of action, nor would the right of either party in so doing be barred by the statute."

The *Muir* case clearly establishes that a husband is not a necessary party for the purposes of commencing an action for recovery of personal injuires to a married woman. Thus the statute tolling the statute of limitations (5-230), if it still existed, is inapplicable by its own terms to the instant action. The appellant could at any time have brought her action in her own name. As her husband, under the law of *Muir*, was not a necessary party, there was nothing in her status to toll the statute.

We refer above to Section 5-230, "if it still existed", because in actuality it has been repealed by implication. That statute was first enacted in 1881. In 1903, Idaho enacted the so-called "Rights of Married Woman Act," now Section 5-304, providing as follows:

"A woman may while married, sue and be sued in the same manner as if she were single: provided, that except in actions between husband and wife the husband shall not be chargeable with the wife's costs or other expenses of suit."

By terms of the bill enacting this statute, all statutes in conflict with it were repealed. As noted in *Muir*, Section 5-230 is in conflict with the Married Women's Act, and thus it must be held to have been repealed. (For a

more complete discussion of this issue, including a complete history of the two acts, as well as the two-year statute of limitations applicable here, Section 5-219, see our Memorandum in Opposition to Plaintiff's Motion to Amend, which is included in the clerk's transcript herein, T.R. 134-165. This memorandum was subsequently incorporated in this appellee's motion for summary judgment, T.R. 179-181, upon leave of the Court, T.R. 174.)

Even assuming, *arguendo*, that the statute tolling the statute of limitations were applicable, which we deny, and that the statute could be further tolled upon Appellee White's leaving the state on September 1, 1961, which we also deny, this matter is barred in any event. In accordance with the finding of the court, the married woman's disability would be removed by divorce on September 1, 1959 (T.R. 219). The time period from September 1, 1959, to September 1, 1961, is more than the two years permitted by the applicable statute of limitations. In computing time for purposes of statutes of limitations, the day on which the act in question was done is to be included. *Dowling v. Lester* (Georgia, 1946), 29 S.E.2d 576; *Gibson v. Kelley* (1953), 88 Ga. App. 817, 78 S.E.2d 76. Thus the time for commencing the action expired on August 31, 1961, while Appellee White was still in the state (Finding of Fact No. III, T.R. 219.)

In short, the appellant's contentions are without merit. Whatever the theory, the two-year statute of limitations set forth in Section 5-219 of the Idaho Code had expired before this action was commenced. Thus the dismissal was correct, and it must be upheld.

IV

THE APPELLANT'S CAUSE OF ACTION IS NOT SAVED BY ANY ABSENCE OF APPELLEE WHITE FROM THE STATE OF IDAHO SUBSEQUENT TO SEPTEMBER 1, 1961.

As noted above, counsel for appellant contends, at page 54 of his brief, that the absence of Appellee White from the State of Idaho after September 1, 1961, tolled the statute of limitations from that date on by virtue of the provisions of Section 5-229 of the Idaho Code that time of absence of a defendant "is not part of the time limited for the commencement of the action."

The trial court did not rule on this contention, having concluded that the appellant's cause of action accrued on September 1, 1951, and that the statute of limitations was not tolled by her marital status (T.R. 219, 220). Thus any question of absence of Dr. White some ten years later became moot. Furthermore, as discussed above, even if the statute had been tolled by the appellant's marital status until divorce September 1, 1959, the allowable time for commencement of suit expired on August 31, 1961—the day before Dr. White left the state.

The court found as a finding of fact:

". . . that all of the defendants were subject to the jurisdiction of this court, with the exception that during a part of the time between September 1, 1961, and the date of the filing of the complaint herein, on October 14, 1963, the defendant Raymond L. White was absent from the State of Idaho, and as respects the defendant, St. Luke's Hospital, a corporation, said hospital was incorporated, present

within the jurisdiction, and amenable to service of process at all times referred to herein." (Finding of Fact No. III, T.R. 219.)

This finding is fully supported by sufficient evidence (R. 27, 195, 196; T.R. 170-171, 177-178, with regard to presence and absence of Appellee White; T.R. 182, 183-185, with regard to continued presence of Appellee St. Luke's Hospital).

Thus, even if it could somehow be said that an action remained against Appellee White, which we deny, it is abundantly clear that as to this appellee, St. Luke's Hospital, the limitations period had expired long before the suit was commenced. St. Luke's Hospital never went anywhere. It could and should have been sued, if at all, within two years of the accrual of the cause of the action—by August 31, 1953, or, even assuming the validity of the married woman contention, by August 31, 1961. Any way that it is calculated, the date of filing—October 14, 1963—was far too late. This is so even if it were conceded that Appellee White was the agent of the hospital, as it is not necessary to join principal and agent as joint tortfeasors. 2 Am. Jur., Agency, Section 437.

Thus the judgment of dismissal must be affirmed.

V

THE COURT PROPERLY DISMISSED THE COMPLAINT IN THAT THE APPELLANT DELAYED UNCONSCIONABLY LONG, TAKING INADEQUATE ACTION, AFTER THE ALLEGED DATE OF DISCOVERY AND BEFORE SUIT.

As argued above, the record evidence and the findings of fact by the court are fully sufficient to support its determination that the discovery rule should not be applied to the instant cause, and that the complaint, therefore, was properly dismissed. However, as we argued before the trial court (T.R. 72-74), even if that determination were wrong, and if the cause of action could be said to have accrued with the August, 1962, "discovery" of the alleged malpractice, the action should still be barred by the appellant's further delay before filing suit—more than thirteen months later.

This Court made it clear in the remanding decision that application of the discovery rule to save an otherwise stale claim should be tempered by equitable conisderations such as a plaintiff's diligence and promptness in acting as compared to the attendant prejudice to the potential defendants:

> "This suggests, in our estimation, that the discovery doctrine is itself subject to some restraint as the time from the occurrence of the malpractice grows greater. In such circumstances, the considerations of fairness to the defendant underlying statutes of limitation become more insistent, while the plaintiff's appeals to equity implicit in the discovery doctrine become less so. We believe the Idaho courts would apply a concept akin to the equitable doctrine of laches to limit the discovery rule, a rule which itself has its genesis in equity. Thus, the suit of a plaintiff who is reasonably diligent may be barred if the defendant shows undue prejudice because of an extreme lapse of time between the commission of the wrongful act and the commencement of suit."

Here more than a decade elapsed between the alleged error and the date of discovery. In and of itself, this

period would be compelling upon a court acting equitably to hold that a defendant ought not to be subjected to suit upon deteriorated evidence. Thus, in the case of *Wilder v. Haworth*, 213 P. 2d 797, cited by the Court of Appeals, the Oregon court stated the following:

> "Moreover, broad consideration of justice required that there should be statutes of repose to prevent presentation of stale claims and discourage the assertion of fraudulent ones. 'The statute of limitations is a statute of repose, designed to protect the citizens from stale and vexatious claims, and to make an end to the possibility of litigation after the lapse of a reasonable time.' *Guaranty Trust Co. of New York v. United States*, 304 U.S. 126, 58 S. Ct. 785, 790, 82 L. Ed. 1224. Such protection is especially necessary in cases of the present sort. The physician and surgeon often are handicapped in their defense, because of the mute appeal that is made to the sympathies of jurors by the pitiable condition of plaintiffs in many malpractice cases. For obvious reasons, they should not be further handicapped by having to combat stale claims."

All the considerations set forth in the *Wilder* case demand that this appellant's suit be barred. But in addition to the long, and as previously noted, unnecessary, lapse in time between the alleged wrong and the date of discovery, the appellant then waited more than a year before instituting suit. It should be noted that many of the cases cited by the Court of Appeals in its discussion of the equitable considerations in applying the discovery rule were cases in which the statute of limitations period was set at a year. *Hundley v. St. Francis Hospital*, 327 P. 2d 131 (1958); *Greninger v. Fischer*, 184 P. 2d 694 (1947); *Costa v. Regents of University of California*, 254 P. 2d 85; *Agnew v. Lar-*

son, 185 P. 2d 851. Here the long delay is laches upon laches which has accumulated while the evidence has grown stale. Speaking in *Chemung Mining Co. v. Hanley, supra*, cited by the Court of Appeals, the Idaho Supreme Court set itself against dilatory practices, stating the following with regard to the trial court's discussion in denying an amendment:

> "Section 4229 was inacted for the protection of the diligent and those who have acted in good faith, and not for those guilty of inexcusable laches or who have neglected to preserve their rights when they have had abundant opportunity accorded them for that purpose."

Waiting more than a year after passage of more than a decade is too much in itself, but it is even worse when we consider what the appellant did during that time. She learned that a doctor disagreed as to the reading of a slide—an event that could happen without a hint of malpractice—and she went to a lawyer (R. 178, 180). Then she did nothing. There is nothing to show that either she or anyone for her sought any corroborating evidence or additional facts to suggest malpractice. There was nothing further to bring to the court a showing that she had been wronged and that special circumstances warranted giving her a day in court despite the delay. There was nothing but delay, and nothing offered to justify it. Then, finally, the appellant (or her counsel) filed suit without giving notice to the appellee hospital of a possible claim—without making a demand. She testified that she "knew" Appellee McCarter had received "notice" from Dr. Shaw and that she "assumed" he would tell Appellees Popma and White (R. 179). But she never even mentioned the appellee hospital. And, the "notice" to which she referred was hardly what one could consider a usual notice of

claim (R. 78). Counsel for appellant may contend that Appellee McCarter was in fact an agent of Appellee St. Luke's Hospital, but as discussed in a subsequent portion of this brief, there was no such showing.

In short, the appellant delayed eleven years before making inquiry as to the diagnosis. And if that is not enough to bar the claim, she and her counsel then delayed another thirteen months before filing suit. Bear in mind that this was not a delay of thirteen months after injury, as in the typical tort cases—this was thirteen months of unconscionable delay piled upon eleven years of unconscionable delay. Surely either is too much. Taken together, the conclusion must be that the appellant has waited too long, and that the judgment of dismissal must be affirmed.

VI

THE COURT PROPERLY DISMISSED THE COMPLAINT AS TO APPELLEE ST. LUKE'S HOSPITAL FOR THE FURTHER REASON THAT THERE WAS NO SHOWING THAT THE HOSPITAL WOULD BE LIABLE EVEN IF MALPRACTICE WERE PROVED ON THE PART OF THE DOCTORS.

At page 4 of this Court's opinion establishing the law of this case (T.R. 60), it was made clear that the plaintiff has the burden of justifying a long delay in bringing suit:

> "In addition, the burden of establishing a claim rests upon the plaintiff, and the stale nature of the evidence cuts two ways, mitigating against him as well as the defendant."

Here, the appellant seeks to assert a twelve-year-old claim against the appellee St. Luke's Hospital, but as argued before the trial court (T.R. 67-69, 81-83), there was no showing of any facts to justify dragging this hospital through the courts so many years after its only possible relation to the suit—or, for that matter, at any time.

The trail court rejected certain offers of proof by this appellee to show the lack of any master-servant or principal-agent relationship between the doctors and the hospital (R. 190, 192). However, the record as it stands is fully sufficient to sustain this argument upon appeal as a further reason for affirming dismissal of the complaint. As noted above, this Court placed the burden upon the appellant, and the appellant has failed to meet it.

In the first place, the appellant failed to offer any evidence of a master-servant relationship between the doctors and the hospital, even though the authorities hold that physicians do not generally stand in such a relationship:

> "Cases generally hold that the hospital is not liable for the negligence or malpractice of a staff physician in the treatment of his patient in the hospital. Emphasis is generally placed upon the contract for medical treatment between patient and physician, and the absence of any right of the hospital to control the physical conduct of the physician while he is ministering to the plaintiff." *Hospital Law Manual*, Health Law Center, University of Pittsburgh, Vol. IIa.

See also *Restatement of the Law of Agency, 2d*, Section 223, Comment A., recognizing that normally physicians employed by a hospital are not servants of the

hospital and it is only under particular circumstances that such is the case.

This precise question has not been considered by the Idaho Supreme Court, but authorities from other jurisdictions are relatively plentiful. The Colorado Supreme Court, for example, stated the following in the case of *Rosane v. Senger*, 149 P.2d 372, 374 (1944):

> "A hospital, a corporation as here, cannot be licensed to, and cannot, practice medicine and surgery. The relation between doctor and patient is personal. That a hospital employs doctors on its staff does not make it liable for the discharge of a professional duty since it is powerless under the law, to command or forbid any act by them in the practice of their profession. Unless it employes those whose want of skill is known, to it, or by some special conduct or neglect makes it so responsible for their malpractice (and no such allegation here appears) it cannot be held liable therefor."

The Illinois case of *Hoke v. Harrisburg Hospital*, Inc., 211 Ill. App. 247, involved a radiologist employed by the hospital, of which he was a shareholder and with which he divided earnings from x-rays. Even there the court held that the hospital was not liable for burns caused during the taking of x-rays, stating at page 252:

> "Even though Dr. Nyberg had been employed by the defendant as an x-ray specialist to operate the machine and to give x-ray treatments to the patients in the hospital, that would not in itself establish the relationship of master and servant so as to make the hospital liable for his negligent acts. The general rule is that such x-ray specialist is regarded as in the

same professional class as a doctor and proceeds upon his own judgment as to how and what should be done."

In the 1957 California case of *Mayers v. Litow*, 316 P.2d 351, an action against staff physicians and a hospital, the court affirmed a non-suit of the hospital:

"The judgment of non-suit in favor of defendant Midway Hospital was patently correct. Defendant Litow performed the surgery with the assistance of Dr. Feinstein. No evidence was introduced to show that any other possible agents or employees of the hospital were present during the operation. These two doctors were both on the staff of defendant Midway Hospital; this meant they were privileged to bring their cases to the hospital. Normally the question of agency is one of fact for the jury, (citing authorities) but in this case there is nothing in the record from which it may legitimately be inferred that defendants Litow or Dr. Feinstein was an agent or employee of the hospital."

In the Georgia case of *Porter v. Patterson*, 107 Ga. App. 64, 129 S.E. 2d 70, 74 (1962), the court found the hospital liable for acts of nurses in its employ, but recognized that the hospital would not be liable for medical acts:

"In taking this view these courts classify the acts of nurses and other employees for which the hospital is liable in tort as administrative or clerical acts, and the acts for which it has no liability as those which require medical skill or judgment (see 41 C.J.S., Hospitals, §8, p. 348) whether an act is merely administrative so that negligence in its performance is imputed to the hospital, or non-administrative depends on the nature or character of the act."

To the same effect is *Swigerd v. Ortonville*, 246 Minn. 339, 75 N.W.2d 217:

> "In taking this view these courts classify the acts of nurses and other employees for which a hospital is liable in tort is administrative or clerical acts, and the acts for which it has no liability as those which require an exercise of medical skill or judgment."

Where the physician in question maintains his own practice as well as serving on the staff of the hospital, it is almost universally held that he is not a servant of the hospital and that the hospital cannot be liable for his acts of malpractice. See *Hoke v. Harrisburg Hospital, Inc., supra; Mayers v. Litow, supra; Fowler v. Norways Sanitorium*, 112 Ind. App. 347, 42 N.E. 2d 415 (1942); *Smith v. Duke University*, 219 N.C. 628, 14 S. E. 2d 643 (1941); see also cases collected at 69 A.L.R. 2d 305, 325-332. Here both of the doctors alleged by the appellant to have been agents of St. Luke's Hospital—Appellee McCarver and Appellee White—maintained their own practices outside the hospital (R. 91,195).

In view of this general rule that a hospital is not liable for the medical acts of its staff physicians, it was incumbent upon the appellant to present evidence that she had a right to sue this hospital for the alleged acts of the appellee doctors. This would be so in any case—but particularly here where some twelve years have elapsed since the acts in question, with the evidence grown stale, and where the Court of Appeals has specifically stated that the burden of thus establishing a claim is upon the appellant.

Counsel for appellant at the June 2, 1965, hearing, at which he was supposed to offer evidence to justify

applying a rule to allow suit far beyond the applicable limitations period, called Drs. White and McCarter to the stand. But he asked them nothing with regard to the involvement of St. Luke's Hospital in their treatment of the appellant. In fact, when counsel for this appellee attempted to ascertain this information on cross-examination, counsel for appellant objected (R. 91, 158, 159, 190, 192). What was revealed, however, was that as respects the interpretation of slides, the medical activities of the pathologist, the hospital exercised no control (R. 91). The department head status and supervision by the hospital as respects Appellee McCarter were shown to be limited to record keeping and administrative functions (R. 90-91), which are of course not involved in this case. All that was shown as to Dr. White was that he performed the various surgeries at the hospital.

Counsel for appellant makes much of an argument that there was a continuing doctor and patient relationship between Appellee White and the appellant until well into the permissible statutory period (actually, the amended complaint alleges September of 1961—still more than two years before the filing of the action). As discussed above, the court found, on substantial evidence, that such was not the case (Finding of Fact No. 12, T.R. 119). However, even if it were, there was neither evidence nor argument of any continuing relationship with the appellee hospital. On the contrary, it was shown that, except for the 1956 thyroidectomy, all of the post-1952 contacts of the appellant with Appellee White occurred at his private office in Boise, rather than at St. Luke's Hospital (R. 195). Except for her treatment in connection with the 1951 surgery and the 1956 thyroidectomy, her only relationship with the hospital was sending checks to pay her bill (R. 170).

In short, the appellant has made no showing against the appellee hospital. Under the principles laid down by this Court in *Owens v. White, et al, supra,* it is clear that her claim is barred by the Idaho two-year statute of limitations unless she can show special circumstances delaying its operation. Surely one of these must be that she is suing a defendant that would have legal liabiilty if malpractice were proved. Having failed to do so, and upon application of the equitable considerations dictated by this Court, that claim must fail. Whatever the ruling may be as to the other findings and conclusions of the trial court, the judgment of dismissal as to this appellee must be affirmed.

CONCLUSION

In sum, what we have here is an attempt by the appellant to bring a claim far beyond the time allowed by the statute of limitations without any sufficient showing why she should be permitted to do so. Stated simply, the appellant is a skilled nurse, conscious of cancer and well aware of the improving techniques of diagnosis of that type of disease. She had notice even prior to the surgery she complains of that a mistake may have been made, she had full opportunity at any time thereafter to ascertain the facts of her case, and yet for more than a decade she did nothing.

The trial court, following precisely the procedure spelled out by this Court in its remanding opinion, has entered its findings of fact fully supported by substantial, competent evidence. From those facts it reached the only conclusions it could—that the appellant's claim, if any, accrued at the date of the acts complained of, that there was no showing of due diligence sufficient to justify application of the so-called discovery rule,

that prejudice to the appellees outweighs the desirability of allowing the appellant to present her claim, that under Idaho law the statute of limitations was not tolled by the appellant's marital status, and that, therefore, the twelve-year-old claim is barred by the two-year statute of limitations.

Over and above all the foregoing, it is manifest from the facts that the appellant should be barred by a further unconscionable delay of more than thirteen months after the alleged discovery of the wrong and, as to Appelle St. Luke's Hospital, a complete failure to show that the hospital could be liable even if malpractice were proved on the part of the doctors.

The trial court's dismissal of the appellant's complaint must be affirmed.

Respectfully submitted,

MOFFATT, THOMAS, BARRETT
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By _____
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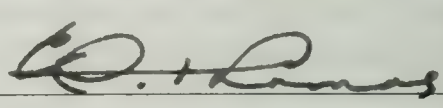
CERTIFICATE

I hereby certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth

Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



Of attorneys for Appellee
St. Luke's Hospital

CERTIFICATE OF MAILING

I hereby certify that on the 20 day of May, 1966, I served three copies of the foregoing BRIEF OF APPELLEE ST. LUKE'S HOSPITAL upon the following:

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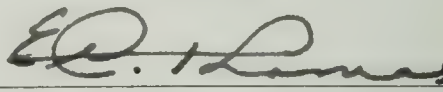
by depositing said copies thereof in the United States mail, postage prepaid, in envelopes addressed to said attorneys as indicated above, which addresses are the last addresses of the attorneys known to me.



Attorney for Appellee St. Luke's Hospital

No. 20,585

In the United States Court of Appeals

for the Ninth Circuit

ANITA T. OWENS
Appellant,

vs.

RAYMOND WHITE, JOHN C. McCARTER,
ALFRED POPMA, and ST. LUKES
HOSPITAL, a corporation
Respondents.

APPEAL FROM SUMMARY JUDGMENT OF DISMISSAL
OF THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO,
SOUTHERN DIVISION

HONORABLE RAY McNICHOLS, Judge

BRIEF OF RESPONDENTS
DOCTORS RAYMOND WHITE,
JOHN C. McCARTER and
ALFRED POPMA

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HONORABLE RAY McNICHOLS, Judge

BRIEF OF RESPONDENTS
DOCTORS RAYMOND WHITE,
JOHN C. McCARTER and
ALFRED POPMA

STATEMENT AS TO JURISDICTION AND FACTS

No question has ever been raised as to the jurisdiction of the Federal Court over this case. The Plaintiff at the time of the commencement of the action was a citizen of the State of California. All four Defendants were citizens of the State of Idaho. The amount in

controversy exceeded the sum of $10,000.00 over and above interest and costs.

The Statement of Facts as set out in Appellant's Brief is, to say the least, about as favorable to her as could be done. We could give another side of the picture but it would only belabor this Court and, in the final analysis, we believe that in our Argument we have pointed out that the Findings of Fact are well supported by substantial evidence and any controversy or conflict in the facts becomes entirely immaterial.

POINTS AND AUTHORITIES

I.

Limitation of actions in Idaho for personal injuries is statutory.

Sec. 5-219 (4) Idaho Code

II.

Even though it is entirely possible for different minds to reach different conclusions upon the facts, the rule of presumption of correctness of the decision of the trial Court reached upon trial in which the witnesses are present, requires that "however meager" the supporting evidence may be, the findings of the trial Court must be sustained.

Chatterton vs. Luker
66 Idaho 242
158 P 2d 809

Nelson vs. Altizer
65 Idaho 428
144 P2d 1009

Loosli vs. Heseman
66 Idaho 469
162 P2d 393

Conley vs. Amalgamated Sugar Co.
74 Idaho 416
263 P2d 705

In Re Randall's Estate
58 Idaho 143
70 P2d 389

Smith vs. Clearwater County
65 Idaho 271
143 P2d 561

Watkins vs. Watkins
76 Idaho 316
281 P2d 1057

Angleton vs. Angleton
84 Idaho 184
370 P2d 788

Rule 52 IRCP

III.

In Idaho a married woman may commence and maintain an action in her own name for her personal injuries without joining her husband as a party plaintiff.

Muir vs. City of Pocatello
36 Idaho 532
212 Pac 345

Lorang vs. Hays
69 Idaho 440
209 Pac 2d 733

Frederickson & Watson Constr.
Co., et al vs. Boyd
102 Pac 2d 627

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1874-75, p. 80

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1880-81, p. 35

Revised Statutues of Idaho 1887,
Section 4093

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1903, p. 346

Sec. 5-230(4) Idaho Code

ARGUMENT

In our opinion the Appellant has not only missed the points of law involved, but has entirely misconstrued the opinion of this Court on the former appeal as found in Owens vs. White, et al, 342 Fed 2d 817. In that opinion Judge Koelsch, speaking for the Court said, among other things:

"Whether plaintiff's claim has accrued is a question of law (**Chemung Mining Co. vs. Hanley**, 9 Idaho 786, 77 Pac. 226 (1904)), and like all issues of law must be resolved by the court even though this will require evidence; in other words, the issue presents a preliminary matter for the court, rather than the jury, since it does not reach the merits of the claim but instead involves the very existence of the claim itself. ***"

Again, this Court suggested in its opinion:

"This suggests, in our estimation, that the discovery doctrine is itself subject to some restraint as the time from the occurrence of the malpractice grows greater. In such circumstances, the considerations of fairness to the defendant underlying statutes of limitation become more insistent, while the plaintiff's appeals to equity implicit in the discovery doctrine become less so. We belief the Idaho courts would apply a concept akin to the equitable doctrine of laches to limit the discovery rule, a rule which itself has its genesis in equity. Thus, the suit of a plaintiff who is reasonably diligent may be barred it the defendant shows undue prejudice because of an extreme lapse of time between the commission of the wrongful act and the commencement of suit. ***"

And, lastly, this Court gave the following admonition:

"Factors which might be considered in making such a determination would be illustrated by but not limited to: the nature of the alleged injury, the relative difficulty of proving the wrong as contrasted with rebutting that proof, the availability of witnesses and records, the existence of a continuing relationship between doctor and patient, and the inherent difficulty

of discovering certain wrongs."

As heretofore pointed out Appellant has not only missed the points of law involved in this case but has entirely misconstrued the opinion of this Court in **Owens vs. White, et al**, 342 Fed 2d 817, and from page 29 to the middle of page 54 has not only argued that this Court opinion was wrong but that the trial Court erred in following it. She insists, notwithstanding this Court's opinion, that the "discovery doctrine" was a question of fact for the jury in harmony with their demand that a trial be had upon all issues of fact. If, in the judgment of the Appellant, this Court's opinion in **Owens vs. White et al, supra**, was erroneous her duty was plain to petition for rehearing and point out the errors. This was not done and that opinion stands as the law of this case and the directional procedure to the trial Court.

Agreeable with the opinion of this Court and the admonitions and suggestions therein contained, the trial Court on June 2, 1965, spent a very, very long day in taking testimony from all parties involved in the action, and from this testimony made certain Findings of Fact which will hereinafter be referred to.

Almost at the outset of Appellant's brief, on page 16 thereof, it is argued that the basis for the "discovery doctrine" as set out in the Idaho case of **Billings vs. Sisters of Mercy of Idaho**, 86 Idaho 485, 389 Pac 2d 224 (1964) has been recognized in this state, as announced i

Gerlach vs. Schultz, 72 Idaho 507, 244 Pac 2d 1095 (1952). The "discovery doctrine" as used in malpractice cases is purely a rule of equity and this has been overlooked by the Appellant. **Gerlach** is a case based upon fraud and the statute of limitations in affect at the time of the **Gerlach** decision was as follows:

> "Section 5-218 I.C.
> 1. ***
> 2. ***
> 3. ***
> 4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake."

The applicable statute that we are dealing with in the current case is Section 5-219 I.C., which is as follows:

> "Section 5-219 I.C.
> 1. ***
> 2. ***
> 3. ***
> 4. An action to recover damages for an injury to the person, or for the death of one caused by the wrongful act or neglect of another.
> 5. ***
> 6. ***"

Thus, it is seen that these cases dealing in fraud and the discovery thereof have no application whatsoever to the case at hand.

It is utterly astounding that the Appellant should argue that the matter of summary judgment should be

raised by an answer, in light of the record in this case. At the time the motion for a summary judgment was being discussed the question arose as to whether, in the light of the record, the Defendants should be required to file their answer and set up the matters that were being raised by the motion, and the trial Court very apt made this observation to Mr. Vernon K. Smith, trial counsel for the Appellant, which starts at page 18 of Volume 3 of the Transcript of Record on Appeal in this case:

> "THE COURT: Well, you have touched on one thing and I have a feeling that this is important in this case and it no doubt will go to the Circuit Court again, I think it was unfortunate that it went without the key issue being decided the other time and it was not necessary for it to occur. It shouldn't have been necessary to have more than one appeal.
>
> The first thing that worries me is your contention that the matter on the summary judgment doesn't properly bring these issues before the court as of today. I want to ask you if you stand on that position because certainly the defendants could promptly this afternoon file answers in which they raise the Statute of Limitations and they recopy and file their motion for summary judgment. What I am asking you is if that is what you want to stand on because then counsel might want to protect themselves, file their answers and then a summary judgment.
>
> MR. SMITH: I can't see where I would gain by it.

Clearly and without any further comment whatever we have the acceptance of the Appellant that the Court should decide the matter on the record as it stood, without requiring the Defendants to plead the statute of limitations by way of answer. If the above is insufficient, we call the Court's attention to Finding No. II of the Findings of Fact and Conclusions of Law as found in the Clerk's Transcript at page 219, which is as follows:

> "At the said hearing of August 23, 1965, counsel for the plaintiff stipulated that the Motion for Summary Judgment was properly before the court and directed to the plaintiff's Amended Complaint, waiving the objection that an Amended Answer to the Complaint, or in the alternative, a Motion raising the Statute of Limitations, had not been made."

With what grace can the Appellant now argue before this Court that the trial Court committed error in considering the matter of the statute of limitations on the motion for a summary judgment without it being pled in an answer?

The next question now raised by the Appellant is that the findings of fact made by the trial Court are supported by no or insufficient evidence. At the hearing before the Court on June 2, 1965, the question for determination was whether the "discovery doctrine" should be invoked in this case. That was the question of fact to be determined by the Court under all of the evidence,

facts and circumstances.

Before we go to the facts let us examine the Idah Law so we will know what yardstick to use as a measu ment. There are many cases in Idaho on this question In **Chatterton vs. Luker,** 66 Idaho 242, 158 P 2d 809, was said by Justice Miller speaking for a unanimous Court, as follows:

> "(3-5) We think all that need be said relative to the evidence, or the sufficiency thereof, is governed by the following authorities:
>
> The recent case of **Checketts v. Thompson,** 65 Idaho 715, 152 P 2d 585, wherein it is said:
>
> 'This Court has repeatedly held that where conflicting evidence is submitted to a trial court sitting without a jury, either as a court of law or as a court of equity, the findings of the court on questions of fact will not be disturbed where there is competent evidence to support them. (**Viel vs. Summers,** 35 Idaho 182, 209 P. 454; **Davenport v. Burke,** 30 Idaho 599, 167 P 481; **Lus v. Pecararo,** 41 Idaho 425, 238 P 1021; **Collins v. Hibbard,** 48 Idaho 178, 279 P. 619; **Snell v. Stickler,** 50 Idaho 648, 299 P 1080; **State v. Snoderly,** 61 Idaho 314, 101 P 2d 9; **Roddy v. State (Idaho),** 139 P 2d 1005; **Picciano v. Miller (Idaho),** 137 P 2d 788; **McCarty v. Sauer (Idaho),** 136 P 2d 742.'
>
> And again, in the case of **Nelson vs. Altizer,** 65 Idaho 428, 144 P 2d 1009, it is said:
>
> '"Furthermore, where the facts "might very

well lead different minds to reaching different conclusions upon the issue presented; and where such is the case, however meager the evidence, if it is of a substantial nature and character (as in the instant case), the findings of the triers of fact should prevail." (McKissick v. Oregon Short Line R. Co., 13 Idaho 195, 89 P. 629; Fleenor v. Oregon Short Line R. Co., 16 Idaho 781, 803, 102 P 897; Denton v. City of Twin Falls, 54 Idaho 35, 43, 28 P 2d 202; Call v. City of Burley, 57 Idaho 58, 62 P 2d 101, 105." (Dickey v. Clarke (Idaho), 142 P 2d 597, 602.")

And again, in the case of Wieri vs. Anaconda Copper Mining Co. (Montana), cited as 156 P 2d 838, it is said:

'On the review of a decision of the District Court the presumption is that the decree of that court is correct (citing cases), and that its judgment will not be set aside unless there is a clear preponderance of the evidence against it.'

Again, in Conley vs. Amalgamated Sugar Co., 74 Idaho 416, 263 P 2d 705, the Idaho Court said:

"After the court has found, the criteria are not what other or different findings the evidence could or would sustain, not what findings are plausible, not the weight or quality of the evidence or credibility of witnesses, but the sole criterion is simply whether there is substantial evidence, regardless of conflict, to sustain the findings as made, with all reasonable inferences and intendments in favor thereof. This proposition is so universal, so oft repeated and

> adhered to as to need no citation of authority in support thereof. It is not what evidence tends to support appellant, or negative that favorable to respondents, but it is what evidence tends to support respondents, with all reasonable inferences and intendments to be drawn in favor of respondents, which controls the determination of the controversy in this Court."

Is there then substantial evidence, regardless of conflict, to sustain the findings as made by the trial Court with all reasonable inferences and intendments in favor thereof? We will discuss these findings in the order in which they are attacked.

Finding No. 1

> "That the plaintiff was, for a number of years prior to the surgery, a registered nurse, actively pursuing her profession, and was a college graduate with a degree of Bachelor of Science in that field."

At page 100 Tr. commencing at line 3, we find the Appellant testifying:

> "Q Now prior to August of 1951, Mrs. Owens, where were you living?
>
> "A Prior to what?
>
> "Q August of 1951.
>
> "A Immediately prior I was in Pocatello for a few months but for several years before that I lived in Salt Lake City.
>
> "Q At Salt Lake City what training or education did you receive there?

"A Bachelor of Science degree in education from the University of Utah.

* * * *

"Q Did you work in a hospital there at Salt Lake University?

"A In the University Hospital.

"Q Was this during your marriage?

"A Yes.

"Q What period of time did this cover, if you remember?

"A I worked at Salt Lake General for about a year and a half between 1948 and 1950, I think--no it was 1947 and 1949.

"Q You worked in the Salt Lake General Hospital?

"A Yes."

And again at page 103, commencing at line 11 through line 24:

"Q All right, now your nurse's training and background, Mrs. Ownes, what has that taught you or what had that taught you concerning the selection of a doctor and the sticking with that doctor once your selection has been made?

"A Well, I was cancerwise because I had been working with Dr. Wintrobe in Salt Lake City, who is a leader in a type of malignancy-- blood disorders--and I had

> been teaching and I worked with doctors and I know they are not all of equal ability, the same as any field, and my feeling was that you take your time im making selection and then after you made it if they say, "Put your head in a barrel," you say, "Where is the barrel."

Commencing at line 19, page 149 of the Transcript, the Appellant advises the Court that she had continued her nurse's educational training by attending a workship at the University of Colorado in 1955, had attended Wayne University in Detroit, Michigan, and on page 150 of the Transcript at lines 13 to 22, she was a nurse in the Ar during the years 1943 and 1944. At page 147, commen with line 11 of the Transcript the Appellant advised the Court that she took her nurse's training at the Good Smaritan Hospital in Portland, Oregon, which involved three years of study, and that she is a registered nurse This was in 1943.

There can be no doubt that there is substantial evidence to sustain the trial Court's Finding No. 1.

Finding No. 2

> "That she remained, during all of the time after the surgery, actively in the nursing profession, working in hospitals, and was also active in cancer prevention work."

About the middle of February, 1952, Appellant returned to Pocatello, Idaho (Tr. p. 109, l. 11) where she immediately went to work for the Bannock Memoria

Hospital (Tr. p. 109, l. 6). Sometime between 1952 and 1956 Appellant joined her husband in Montana for a year, but returned to Malad, Idaho, in 1956, (Tr. p. 146, l. 15) where she worked with the American Cancer Society during 1956, 1957 and 1958 (Tr. p. 114, l. 25). In 1955 she took special training at Wayne University in Detroit, Michigan (Tr. p. 149, l. 25). In 1959 Appellant went to California to enter the employment of the Government in the Veterans Administration Hospital. See testimony commencing at line 25, page 116 continuing over to and including page 118, line 12, in which it is shown that Appellant has been continuously employed as a nurse by the Government in its Veterans Administration Hospital at Palo Alto.

It is not attempted to show all of the activity of the Appellant in the nursing profession since the surgery in 1951, but the above is more than ample to support the Court's Finding No. 2.

Finding No. 3

> "That the plaintiff was orginally advised prior to surgery, that the lump in her left breast was benign. One or two days after the plaintiff was so advised, a defendant called her by phone, to inform her that an error had been made and that the tissue was malignant, in that it was cancerous."

We could, to support this finding, refer to the testimony of the Appellant herself as found at Tr. p. 104,

lines 15 to 22:

> "A He said, "You are a lucky girl. It is benign. You can go home," and so I got up and went home.
>
> "Q When was the next time you heard from Dr. White?
>
> "A The next day, I believe about dinner-time. He called me and said that there had been a mistake and that they did find some malignant tissue cells and I would be in the hospital the next morning."

Finding No. 4

> "That after the surgery, plaintiff was advised by the defendant, Dr. White, that the excised flesh contained no malignant cells, and that all of the malignancy had been in the tissue removed in the biopsy which was performed prior to the surgery."

On page 116 of the Reporter's Transcript commencing at line 16, we find the appellant testifying on direct examination and it answer to a question asked by her own counsel, as follows:

> "A No, I am speaking of the fact that I had been told by a competent expert in the field that this is your diagnosis and I believed it. I even saw the pathology report with--Dr. White, when I was in the hospital and I imagine because I am a nurse and I was apprehensive I wanted to know was it a little amount or

big amount and he said, "I think we got it all," and he showed me the report, I think to be reassuring, and it said they didn't find any malignancy--I saw the pathology report."

Finding No. 5

"That the plaintiff professed to be conscious and worried, at all times after the surgery, of the possibility of a recurrence of development of cancerous cells in her body."

On page 106 commencing at line 8 of the Reporter's Transcript, we find the Appellant giving this answer on her direct examination:

"A Well, I was 31 years old and had two children, one four and one one, and I knew that this was broad generalization but usually your chances of surviving with a malignancy in the sex organs during the child bearing age are not as good as if you are out of the child bearing age. So I was concerned about whether I was going to live or die and I asked Dr. White and he said, "Well, of course, I don't know, but we are going to do everything we can to see that you live," and he outlined what they were going to do."

Again, on page 115, lines 3 to 11, Appellant states that she had checkups and examinations at least once a year, and commencing at line 23 on page 115, she said:

"A I had complete physicals with special attention to whatever I was--a current

> problem. If I would talk about being tired, Dr. White had a PBI--special test to see if the thyroid was regulated. I had blood work, and then a lot of reassurance because the menopause and the breast amputation caused difficulty for me psychologically, I felt. I had some problems and he would--he was helpful with these too.

Even before the biopsy this Appellant was very cancer conscious (Tr. p. 135, L. 14-17).

Again, on page 136 of the Transcript commencing at line 15, we find this:

> "Q Now another reason why you were cancer conscious is that your father died with cancer, didn't he?
>
> "A Yes, that is true.
>
> "Q And your aunt died with a cancer?
>
> "A That is true.
>
> "Q And you gave that history to Dr. White, didn't you?
>
> "A I imagine I did."

In light of the above, how can anyone question the fact that there is substantial evidence to support the Court's finding that the Plaintiff was conscious and worried of the possibility of recurrence of cancerous cells in her body!

Finding No. 6

"That plaintiff knew at all times that great improvements were being made in the diagnosis and detection of cancer in the human body. She worked, through the years after the surgery, in hospitals where laboratories were maintained and pathologists retained."

As elsewhere pointed out Appellant was actively engaged in cancer work with the American Cancer Society as early as 1956, and in 1959 went to California. She worked closely with Dr. Shaw after she went to work at the Government Hospital in California (Tr. p. 119, L. 2-5). She assisted in opening the hospital at Palo Alto in April of 1960 (Tr. p. 119, Ll. 17 & 18).

"Q Now when you were there at the hospital, Mrs. Owens, was there some sort of research going on relating to somewhat of a new technique in connection with early detection of breast mastitoides?

"A We have many research problems in the hospital, one of them is--it had to do with making determinations about the selecting of the breast cancer patients that would be candidates for surgery and done on the basis of--we save urine and measure the calcium--

"Q You are saying calcium in the urine?

"A Well, I will put it--there are many research things going on. ***"

(Tr. p. 120, Ll. 9-21)

On page 130, lines 10-19 Mrs. Owens testified that she worked at hospitals the size of the Defendant St. Luke's Hospital in Boise, and that she had never worked in one of that size that did not have on its staff a pathologist.

Finding No. 7

> "That plaintiff knew at all times that the defendant hospital records and the slides on which the diagnosis was predicated were available for examination and diagnostic examination at her simple request."

With reference to this Finding, Appellant was asl this question:

> "Q As a registered nurse and with the background and experience you have had, you have been aware during the entire period since the operation that the slides and your chart were available to you and your doctor elsewhere if you cared to secure them; isn't that true?
>
> "A Surely."

(Tr. p. 160, Ll. 18-24)

At page 236, starting at line 9 to the comment of the Court at line 25, it appears:

> "MR. MARTIN: The evidence on the behalf of the defendant doctors would show that the records of the plaintiff while in the hospital under care and treatment as well as the care and treatment given by Dr. White and Dr. Popma would have been available to any recognized physician or hospital at any time

upon request. Just as the request of Dr. Shaw was honored.

The evidence would show that no request was received by anyone--made by any doctor or hospital at any time other than that by Dr. Shaw, which request was made on the date as shown by the exhibit.

MR. SMITH: I believe, Mr. Thomas, I would be willing to accept that as a stipulation that Mr. Martin just put in.

MR. THOMAS: Yes, so stipulated."

Finding No. 8

"For a period of eleven years from the date of the surgery she made no investigation to determine the accuracy of the diagnosis on which the surgery was based."

The evidence supporting this Finding is found at pages 142, 143 and 144 of the Transcript and commencing at page 142 at line 9, this question was asked:

"Q Was there anything that Dr. McCarter did or did not do which kept you from making any investigation to see whether the tissue was benign or cancerous which was removed from your breast in 1951?

"A There isn't anything that anybody did in the world that either caused or kept me from making an investigation of the tissue that was taken from me. It never occurred to me to investigate my own tissue. I don't know that much.

(Tr. p. 143, L. 12)

"Q From that answer, I take it, you made no investigation whatever of any kind or character until you attended this Shaw lecture in 1962?

"A I never made any investigation. ***"

(Tr. p. 143, L. 16-20)

Finding No. 9

"That twelve years elapsed between the date of surgery and the date suit was filed."

The surgery, as shown by the record, (Tr. p. 25 L. 6) was performed September 1, 1951. The Complai was filed October 14, 1963 (Clerk's Transcript Volume 1-A, page 6).

Finding No. 10

"That the tissue samples on which diagnosis was had were originally treated and placed on slides, which slides are now deteriorated to some degree."

On page 240, Transcript, between lines 5 and 20, we find Dr. McCarter talking about these deteriorated slides of the tissue of the Plaintiff as follows:

"Q What have you to say to the Court as to whether or not time has deteriorated the color of these slides?

"A Time does as regards all sections and these do show a degree of deterioration of fading and of stains so that they are not as sharp as they were ten years ago.

"Q Or 14 or 15 years ago?

"A Right.

"Q Does that fading made it more difficult for these slides to be interpreted?

"A It does to a degree, yes.

"Q And does it have an effect upon the reading or interpretation of the slides?

"A To a certain extent it does, yes."

Again, at page 246, Transcript, from line 19 to the bottom of the page, we find Dr. McCarter reiterating but in different words, the same thing:

"Q Doctor, at one point you commented there is a change in color. Is that right? Did I understand you right, there is a change in color?

"A There is a fading of stains in practically all sections over a matter of years.

"Q Are they as distinct today in their appearance as they were in 1951?

"A Not as distinct, no."

No attempt was made by the Plaintiffs to introduce any evidence to contradict Dr. McCarter in this regard. However, on a most soul searching cross-examination by Mr. Smith in connection with these slides we find these questions and answers at page 257, Transcript,

lines 11 to 17:

"Q But they are still readable?

"A Yes, readable as you could read an old book in poor light.

"Q What is that?

"A They are still readable in the same sense that you could read an old book in poor light."

Finding No. 11

"That evidence as to the standard of care and competence ordinarily exercised by physicians, especially pathologists in the detection and diagnosis of cancer, in the Boise, Idaho, area, in the year 1951, will be most difficult to procure."

In regard to this Finding we call the attention of the Court to the following testimony, commencing on page 241, Transcript, line 1:

"Q Comparing the present day knowledge of sclerosing adenosis to tissue with sclerosing adenosis tissue in 1951, what advancement has been made?

"A I think that they may be answered by saying that the concept of so-called sclerosing adenosis, a form of proliferation of breast tissue, has been recognized really and first described in the late '40's, as I recall, and that the experience with regard to this diagnosis, of course, has been increased and some attention has been called to it. At the present time

there is considerable more information about sclerosing adenosis than there was 15 years ago. The same with regard to a great many other forms of disease in the breast.

"Q In other words, the science is and has been progressing in these 14 years?

"A Very much so, yes, and not only in the matter of a description of the pathology and the reading of the sections but in the correlation as between the sections and the clinical progress of cases and so on."

And again, on page 242, commencing at line 3 we find this question and answer:

"Q What factors will arise here that will enter into the difficulty in placing this before a jury as of 1951?

"A It is really very difficult to understand what the legal situation is. The scientific situation is that I don't believe that we can go back 15 years as easily as we can go back 5 years to reconstruct what our thinking was at the time and what details of information were available to us which have not been put down in records and which have, however, been communicated as between the surgeon and pathologist and as between the pathologist through his reports to the surgeon, and a number of those details which certainly do have--do add up. None of us can remember things as well back 10 or 15 years as we can 5 years or a lesser time."

On page 243 of the Transcript, Dr. McCarter tells us that Dr. Carl of Twin Falls, Idaho, who has been there two or three years is about the same age as himself and has had the same period of schooling, and that unless Dr. Carl was reading these kind of slides i 1951 he would know of no other doctor available to test

On page 245, Transcript, lines 4-10, we are tol that Dr. Helen Craign was practicing pathology in 1951 but that at the time of the trial she was incapicitated a living in a nursing home. Bless her soul, she has since passed on.

Finding No. 12

> "That while the plaintiff sometimes sought out the defendant, Dr. White, for medical attention, during the years after her surgery, she also saw and consulted other physicians and did not rely solely on Dr. White for medical advice and treatment. That the plaintiff has not lived in the community or general vicinity of Boise, Idaho , from the date of surgery until the present time. That there was not a continuing relationship of doctor and patient after the postoperative surgery and treatment in the usual sense between the plaintiff and the defendants."

There is a conflict in the evidence with reference to this Finding. That Dr. Roberts of Pocatello was ve close to the plaintiff and that she looked to him in the final analysis cannot be disputed. Many times she ma statements of the same or similar import, as:

"A Dr. Ed Roberts in Pocatello, who had been my family physician all my life. ***"

(Tr. p. 102, L. 24)

After she had her surgery and returned to Pocatello, Idaho, in February, 1952, she called on Dr. Roberts and we find this:

"Q What conversations, if any, did you have with Dr. Roberts concerning your past surgery and how you should continue with Dr. White?

"A All about it, really. I showed him the surgery that was very good looking and he thought so too and confirmed what I already knew. ***"

(Tr. P. 110, L. 9-15)

Again, with Dr. Roberts we find this testimony:

"Q Now in 1956 you had Dr. Roberts of Pocatello, E. N. Roberts, who you knew, write Dr. White for your past history so that he could treat you, he, Dr. Roberts, did you not?

"A I don't recall, but Dr. Roberts has been our family doctor all my life and the day I was operated on I think I asked Dr. White to call Dr. Roberts and tell him and he had been in communication with Dr. Roberts simultaneously whenever I was Dr. White's patient."

(Tr. P. 139, L. 25- P. 140, L. 6)

Mrs. Owens testified to checkups by Dr. White but could not give the Court any dates which this was

supposed to have been done.

As opposed to her testimony concerning both vis
examinations, and correspondence, Dr. White testifie
as follows, commencing at page 188, line 13 over to a
including page 189, line 25:

> "Q Did you see her or correspond with her between the month of February, 1952, and when she came back for this tyroidectomy in 1956?
>
> "A It was the month of April, 1952, when I last saw her concerning the breast problem and I next saw Mrs. Owens on January 27 of 1956.
>
> "Q Did you have any correspondence with her between those dates?
>
> "A There was a letter that Mrs. Owens had written to me that she had seen a Dr. Parks in Pocatello---
>
> MR. SMITH: I object on the grounds the letter would be the best evidence.
>
> THE COURT: Well, he is just testifying he received a letter. He is not testifying to anything else.
>
> "A I received a letter from Mrs. Owens.
>
> "Q When after the thyroidectomy did you receive any correspondence from her with reference to giving Dr. Roberts your history of her?
>
> "A Dr. E. N. Roberts of Pocatello?

"Q Yes.

"A In June, 1956, the early first days of June.

"Q Was that transmitted to Dr. Roberts?

"A Yes, sir.

"Q Now, Dr. White, did you either see or hear from her in 1957?

"A I never heard from Mrs. Owens in 1957.

"Q Did you see her in 1958?

"A I saw her in August of 1958 at which time I did a complete physical examination upon her as a routine physical as a general checkup for health.

"Q Now when was the next time that you saw or heard from her and where was she?

"A She was in California and she had written the letter which I mentioned this morning and my reply to her was on October 31, 1959. This was my last contact with the patient."

No attempt has been made to cite all of the testimony supporting the Findings of the trial Court. It is sufficient to say the citations show there is substantial evidence to sustain every Finding and that under the Idaho Law is all that is required.

When the Court rendered its Memorandum Decision on June 22, 1965, eliminating the "discovery doctrine"

from the case, it was obvious that the Plaintiff was out of Court, but in the Memorandum Decision the Co gave to the Plaintiff 30 days within which to file an Amended Complaint in which she could raise the ques tions that had been alluded to during the hearing on June 2, 1965, namely, her status as a married woma the doctor-patient relation between the Plaintiff and Dr. White and the absence of Dr. White from the jurisdiction of the trial Court following September 1, 1961, and by the Amended Complaint these three matters are found as Paragraphs X, XI, and XII of the Amended Complaint. (Clk. Tr. pp. 125 and 126).

Paragraph XI of the Amended Complaint, namely the doctor-patient relation had already been passed upon by the Court as Finding No. 12 in the Findings o Fact of the Court in its Memorandum Decision of June 22, 1965 (Clk. Tr. Vol. 1-A, pp. 116 at 119). Thusly, if the statute of limitations was not tolled by the fact that the Plaintiff was a married woman up to August of 1959, obviously the statute of limitations had run on her cause of action September 1, 1953, more than 10 years before she actually filed her Com plaint. When the Court determined at the hearing on June 27, 1965, that the statute of limitations was not tolled and that Mrs. Owens was not under a handicap or disability and could have filed her action at any tin between September 1, 1951, and September 1, 1953, there was nothing before the Court except to grant the

motion for a summary judgment.

By Paragraph X of the Amended Complaint Plaintiff pled that between the dates of 1951 and 1959 she was a married woman, although she did not plead during any of this time she was living with her husband **(Lorang vs. Hays,** 69 Idaho 440, 209 Pac 2d 733).

A review of the history of Section 5-230(4) I.C. and related statutes as well as the pertinent decisions of the Idaho Court is necessary to an understanding and a decision of this question. Section 5-230(4) I.C. now reads as follows:

> "If a person entitled to bring an action, other than for the recovery of real property, be, at the time the cause of action accrued, either: ***
>
> 4. A married woman, and her husband be a necessary party with her in commencing such action;
>
> The time of such disability is not a part of the time limited for the commencement of the action."

The first statute establishing such disability as a cause for tolling the running of the statute of limitations was enacted by the Territorial Legislature in 1863-64. This statute provided:

> "If a person entitled to bring an action, other than for recovery of real property***be, at the time the cause of action accrued, either ***

> Fourth. A married woman; the time of such disability shall not be a part of the time limited for the commencement of such action." (Territorial Session Laws 1863-64, p. 557).

In the enactment of the Code of Civil Procedure of 1881 the statute was changed to read as it does at the present time (Territorial Session Laws 1880-81, p.3 It has been carried in the same form in subsequent c fications and compilations of the statutes. During thi same period until 1903 there was also in force a stat which required that a married woman's husband be joined with her when she was a party to an action. T statute was first enacted as Section 7 of the Civil Pra tice Act of 1863 (Territorial Session Laws 1863-64, 78). The statute as first enacted provided that:

> "When a married woman is a party, her husband shall be joined with her; except, that when the action concerns her separate property, she may sue alone; when the action is between herself and her husband, she may sue or be sued alone."

This statute was carried in the Revised Laws of Idah (1874-75) in the same form (Territorial Session Laws 1874-75, p. 80). The statute was modified to change the word "shall" to "must" in the first clause and to add two additional exceptions, in the Code of Civil Procedure of 1881. The additional exceptions were:

> "When the action concerns her*** right of claim to the homestead property ***"

and

> "When she is living separate and apart from her husband, by reason of his desertion of her, or by agreement in writing entered into between them ***."
> (Territorial Session Laws 1880-81, p. 35).

The statute was carried into the Revised Statutes of Idaho (1887) as section 4093 in the same form. Thus, while these statutes were in force, the exceptions set out therein were the only cases in which a wife could sue and be sued alone. It was, therefore, a logical part of a unified statutory scheme to also provide as was done in the related statutes, heretofore noted, for the tolling of the statute of limitations in those cases where the husband had to be joined as a party with a married woman. However, in 1903 a married woman's common law and statutory disabilities as to suing and being sued alone were removed. In that year the legislature provided that,

> "A woman may while married sue and be sued in the same manner as if she were single ***".
> (Idaho Session Laws, 1903, p. 346).

While I know of no case which has so held, subsequent code compilers have rightly, it seems, concluded that the old section 4093 of the Revised Statutes of 1887, which provided that a married woman is a party her husband must be joined with her, was repealed by implication, and the text of the act does not appear in any compilation of the statutes since 1887. However, the

compilers have seemingly inconsistently continued to carry the text of subdivision 4 of section 4070 of the Revised Statutes of 1887 (now Section 5-230(4) I.C. This provision seems entirely inconsistent with the 19 act which removed all disabilities married women had theretofore been under so far as being able to sue alon It will be noted that this particular question has been t subject of considerable conflict in other states involvi statutory removal of disability of coverture. (34 Am 166, sec. 209; McIrvin vs. Lincoln Memorial Universi 197 SW 862 (Tenn.); Anno. LRA 1918C, 193). The writer of the annotation last cited after stating the rea given for the conflicting views states that (p. 203)

> "While the weight or trend of authority cannot be said to be clearly one way or the other on this question, the more plausible view seems to be that the disabilities referred to in Statutes of Limitation entitling married women to bring actions within a specified time after the disabilities are removed are not the moral influence or so-called 'quasi-duress' exercised by the husband, but the common-law legal disabilities arising from the marriage relation, and that when these are all, or substantially all, removed by statute, the 'disability' is removed within the meaning of the exception."

It is true that there are still cases where a husb is held to be a "necessary" party with the wife (see Brockelbank, The Community Property Law of Idaho, (Chapter VIII). This, however, is not because a wife under a disability, but because of the substantive law

governing causes of action and rules governing real parties in interest and joinder of parties having joint interests, etc., which substantive law and rules are applicable to all litigants.

Since the disability which gave rise to the need for the provisions of Section 5-230(4) I.C. has been removed, there is no longer any need for this protection.

In considering this question, it is noted at the outset that the various considerations just discussed, which lead to the conclusion that Section 5-230(4) I.C. has been repealed by implication, likewise lead to the implication, it is no longer applicable to cases such as the one under consideration. If this statute is construed in pari materia with the statute enacted by the same session of the legislature requiring that the husband be joined with the wife in all actions to which she is a party with the exception of certain specified cases (Revised Statutes of Idaho (1887) Section 4093), then it would seem that the phrase "necessary party" in Section 5-230(4) I.C. must refer to the related statute (Revised Statute, Section 4093) making the husband a necessary party with the wife. Since Section 4093 of the Revised Statutes was repealed by implication by the act of 1903 in providing that

> "A woman while married may sue and be sued in the same manner as if she were single"

there are no longer any cases in which the husband is a

necessary party in that sense. Therefore, it would appear that even if Section 5-230(4) I.C. is still in forc coverture no longer suspends the operation of the statu of limitation in any case.

Manifestly, there are also other reasons why the statute is not applicable. The general purpose of such statute is to protect a married woman against the runni of the statute of limitations against any cause of action which might have been enforced by her except for her marriage (34 AmJur 164-165, Section 206; 16 CalJur 5 Section 155). The statute should be construed with thi purpose in mind. Viewed in this light the qualifying ph in the statute in question "and her husband be a necess party with her in commencing such action" has added significance. It is the commencement of an action whi tolls the running of the statute of limitations, (5-214, 5-228, I.C.). Hence, if a married woman has a cause of action which she is entitled to bring, and she can co mence the action without the joinder of her husband, th running of the statute of limitations is thereby tolled ar she has no need of the protection of Section 5-230(4) I. C. and does not come within its purpose. This is true even though upon proper objection her husband might b required to be joined later in the action. This likewise conforms to the literal wording of the statute, since th conditions of the statute are not met merely because th husband in some sense could be said to be a "necessar party", but he must be a necessary party in "commenc

the action" i.e., indispensable. Our Supreme Court has directly held in the case of **Muir vs. City of Pocatello**, 36 Idaho 532, 212 Pac 345, that a married woman could commence an action to recover damages for her personal injuries and thereby toll the running of the statute of limitations without joining her husband with her. In the Muir case, the action was commenced by the wife alone to recover for personal injuries within two years after the accident occurred. More than three years after the accident occurred, in the course of the trial, the Defendant was allowed to amend its answer setting up Plaintiff's coverture and Plaintiff was allowed to amend her Complaint by adding her husband as a party Plaintiff. Ultimately the husband and wife obtained a judgment, and on appeal the Defendant contended in substance that the action had not been "commenced" until the husband was made a party and that the statute of limitations had run at that time and the action was barred. However, the Court rejected this argument and held the action had been commenced before the running of the statute of limitations, that is, before the husband had been joined as a party. The Court stated (36 Idaho at page 540)

> "If a married woman has such an interest in an action for injuries to her person or character that she may maintain an action therefor, even though her husband is a proper party, it would follow that her commencing such an action within the limitations period will toll or suspend the running of the statute so that the bringing in of the husband as a party

> after the lapse of this period would not be the substitution of a new or different cause of action, nor would the right of either party in so doing be barred by the statute."

This language clearly recognizes the right of the wife t commence an action for injuries to her person without having the husband joined at the commencement of the action. If the husband had been a necessary party to commence the action the action would have been barre by the statute of limitations since the action was, in fact, commenced by the wife alone and the husband wa not made a party until after the statute had run. In other words, if the husband is a necessary party to commence the action it would have been impossible to hold in the Muir case, and the Court did, that the acti was commenced before the running of the statute.

The conclusion that the husband is not a necessa party to the commencement of such an action is furthe borne out by the language of Justice Rice in concurrin in the Muir case where he stated (36 Idaho at page 544)

> "C.S., sec. 6637 (now Sec. 5-302, I.C.), which is quoted in the principal opinion, grants to a married woman the unqualified and unlimited right to sue. In the cases of **Kohney v. Dunbar**, *** it was held that the wife's interest in the community property is a vested interest of the same nature and extent as that of her husband. There can be no doubt that in case of the failure of the husband to bring necessary actions for the

> protection of the community property, the wife who has been empowered by statute to sue in her own name can maintain any proper action for the protection of her interest in the community property." (Parenthetical material added).

A matter of further significance in considering the Muir case is that if Section 5-230(4) I.C. was applicable, the Court would have had no occasion to determine when the action was commenced for purposes of tolling the statute of limitations. The statute of limitations would not have run against the Plaintiffs in that case, since they were living together and were married both at the time of the accident and at the time of trial. If Section 5-230(4) is applicable to such cases it is extremely remarkable that the Court devoted the extensive consideration it did to whether the action was barred by the statute without once mentioning this section. Perhaps in this regard, a further statement by the Court in the Muir case is significant.

> "A law which attempts to extend to a married woman all the rights and privileges of persons sui juris, where she is seeking to enforce her rights against other persons, and does not give to such persons correlative rights against her, but places her under the disabilities of the common law when being sued, often leads to incongruities and inability to administer exact justice under such system, because no class of citizens can property be given the rights and privileges of fully emancipated citizens without being required to assume the corresponding duties

and obligations of such citizenship.

" * * *

"* * * in jurisdictions having similar statutes, the weight of authority and perhaps the better reason sustain the view that a married woman has such an interest in a cause of action for injuries to her person or character that she should be permitted to maintain actions of this kind, although her husband is a proper or even necessary party, in order to render the judgment res adjudicata against both members of the marital community. It may be questioned whether one of this class of citizens, now fully emancipated under the federal constitution as citizens of the United States, can be deprived of this right solely because of her being a married woman, without denying rights and immunities granted by fundamental law, when other citizens have such rights, particularly in view of C.S., sec. 6637, which provides that: 'A woman may while married sue and be sued in the same manner as if she were single, etc.'

"However this may be, the trend of modern legislation and also of judicial decisions is toward recognizing the right of married woman to sue alone for personal injuries to herself." (Parenthetical material added).

In the Nevada case of **Frederickson & Watson Co Co., et al vs. Boyd**, 102 Pac 2d 627 (1940), Justice Or later a member of this Court, speaking for the Nevada Court, made a beautiful analysis of the status of a married woman with relation to her legal rights.

From the analysis above made there can be no

reasonable doubt in the case at bar of the following:

(a) That the Appellant Anita T. Owens could, under existing law, have commenced an action against these Defendants at any time within two years following her operation in 1951, and that by failing to do so she lost her right of action.

(b) That her then husband Jedd G. Owens was not a necessary party to the commencement of the action.

(c) That the allegation in her Amended Complaint, Paragraph XII, that Dr. White left the State of Idaho on or about September 1, 1961, becomes entirely immaterial.

(d) That the Plaintiff's alleged cause of action is barred by the provisions of Section 5-219(4) I.C. as to all three of the Defendant Doctors.

(e) That there is no genuine issue of any material fact existing in this case and a summary judgment was properly entered.

CONCLUSIONS

All of the argument by the Appellant in the opening Brief about refusal of the trial Court to submit the factual questions presented to a jury just has no foundation whatsoever to stand upon. This Court in the former opinion of **Owens vs. White, et al, supra,** laid down the ground rules for the trial Court to follow and this the trial Court did. In a few instances there was a conflict in the testimony but essentially there is little conflict. The evidence is ample to show that for 12 years the

Plaintiff slept on her right to bring this action and the trial Court held under the facts it would be inequitable to the Defendants to permit the Plaintiff to invoke the "discovery doctrine". The Defendants submit the judgment of the Court should be upheld.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

J. F. Martin

J. F. MARTIN

No. 20,585

IN THE

United States Court of Appeals

For the Ninth Circuit

ANITA T. OWENS,
Appellant,

vs.

RAYMOND WHITE, JOHN C. McCARTER, ALFRED POPMA, and ST. LUKE'S HOSPITAL, a corporation,
Appellees.

Appeal from Summary Judgment of Dismissal of the United States District Court for the District of Idaho, Southern District

Honorable Ray McNichols, Judge

APPELLANT'S CLOSING BRIEF

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APPELLANT'S CLOSING BRIEF

STATEMENT OF JURISDICTION

This is an appeal from Summary Judgment granted on behalf of Appellees. Jurisdiction of the United States District Court for the District of Idaho, Southern District, was properly invoked, the Trial Court having jurisdiction of the action under 28 U.S.C.A., Section 1332, the parties being citizens of different States and the amount in controversy exceeding the sum of $10,000.00, exclusive of interest and costs. This

Honorable Court has jurisdiction to review the order and judgment entered by the District Court under the provisions of 28 U.S.C.A., Section 1291.

STATEMENT OF THE CASE

In a prior appeal to this Honorable Court, a judgment of dismissal on the grounds that the Statute of Limitations had run against plaintiff's claim was reversed. (342 F. 2d 817.) Thereafter, pursuant to certain language found in the prior opinion of this Honorable Court, the District Court held an evidentiary hearing on June 2, 1965, to determine the applicability of the "Discovery Rule". In a Memorandum Decision, filed on June 22, 1965, the District Court rendered Findings of Fact and Conclusions of Law, determining that the "Discovery Rule" ought not to be applied in this case to determine the date of accrual of Appellant's claim. Findings, conclusions and a joint order adverse to Appellant herein was filed on July 19, 1965. By leave of Court, Appellant filed an amended complaint and Appellees moved for summary judgment. The motion was granted and, on September 22, 1965, the District Court entered its judgment of dismissal with prejudice.

The pertinent allegations of the amended complaint are summarized in Appellant's Opening Brief, at pages 3, 4 and 5.

The individual Appellees were employed by Appellant to examine and diagnose a lump in her left breast. During August of 1951, on advice of Appellee

Popma, Appellant submitted to a biopsy performed by Appellee White. Initially, Appellant was informed by Appellee White that the tissue removed during the biopsy was not cancerous; she was later informed that the removed tissues did contain a malignancy and that a certain surgical procedure known as a "radical mastectomy", involving the removal of the left breast and the stripping away of the lymph glands from under her arm, was necessary. Such procedure was performed. In fact, the tissue removed during the biopsy contained no malignancy. Not until the Fall of 1962 did Appellant discover the mistake in diagnosis and that the surgery was unnecessary; prior to the said time, Appellant was not aware of any fact which could put her on inquiry or give her notice that the lump in her breast was in fact benign. There are four claims for relief set forth in the amended complaint. The first claim for relief alleges negligence in the examination and analysis of the tissue taken during the biopsy and negligent misdiagnosis. The second claim for relief alleges a further negligent failure to use due and proper care in making the diagnosis. The third claim for relief alleges negligence in conducting the examination and analysis of the tissue taken during the biopsy. The fourth claim for relief alleges that extensive radiation treatments to which Appellant was subjected following the surgery were unnecessary and occasioned by the negligent and careless misdiagnosis.

This, Appellant's Closing Brief, will deal entirely with the issues of applicability of the "Discovery

Rule". So much of the Opening Brief as dealt with the coverture of Appellant and the absence of one of the Appellees from the State of Idaho is incorporated herein by reference, but will not be repeated.

STATEMENT OF FACTS

In Appellant's Opening Brief, at pages 6 through 14, a careful and detailed statement of the evidence adduced at the June 2, 1965 hearing was set forth. Appellant hereby incorporates by reference that Statement of Facts. Further references and citations to the Transcript will be supplied only as necessary during exposition of the argument.

SPECIFICATIONS OF ERROR

I. The evidence is legally insufficient to support the findings of fact entered by the Court.

II. The Trial Court applied an erroneous legal standard in determining the applicability of the "Discovery Rule".

III. The Trial Court erred in granting the motion to dismiss.

ARGUMENT

I

THE EVIDENCE IS LEGALLY INSUFFICIENT TO SUPPORT THE FINDINGS OF FACT ENTERED BY THE COURT

A

The Applicable Standard of Proof

In our Opening Brief, we contended that some, but not all, of the findings of fact entered below were supported by insufficient or no evidence. Further, it was demonstrated that it was error for the District Court to resolve conflicting reasonable inferences from the undisputed facts in favor of Appellees and against Appellant herein. A single Brief has been filed on behalf of Appellees White, McCarter and Popma; Appellee St. Luke's Hospital has filed a separate Brief. The former of the two briefs contends (pages 2 and 3) that if there be any support, "however meager" for the findings of the Trial Court, they must be sustained, citing numerous Idaho cases dealing with Appellate review of judgments rendered at trial.

Appellees White, McCarter and Popma say (Brief, pages 7, 8 and 9) that Appellant consented to consideration of the Statute of Limitations upon motion for summary judgment. In this, they are entirely correct. Appellant does not now, nor has she previously, claimed that the matter could not be raised by motion for summary judgment. In this regard, see Appellant's Opening Brief, page 17, wherein Appellant, with citation of authority, conceded that the device of summary judgment was available, but denied that it had been properly applied. Appellee St. Luke's

Hospital (Brief, pages 14 and 15) also misreads Appellant's Opening Brief, saying that Appellee asserts that the defense of Statute of Limitations must be raised by answer. Such an assertion would be incorrect; we do not now, nor have we ever, taken this position on appeal.

Although wide of the mark as an attempt to meet Appellant's Opening Brief, Appellees' arguments do raise a significant issue which must be resolved in this appeal. Was the District Court authorized to sever the issue of Statute of Limitations, try the issue without a jury, resolve conflicting issues of fact and of the inferences to be drawn therefrom, and grant summary judgment in the face of the existence of genuine disputed issues of fact and inferences to be drawn therefrom? In testing the sufficiency and adequacy of the evidence to support the District Court's determinations, must this Court utilize the general rule applicable to review of summary judgments or, on the other hand, apply the rule pertaining to review of a full-fledged trial?

No doubt, under Rule 42(b), Federal Rules of Civil Procedure, the District Court was authorized to sever the issue of Statute of Limitations for separate trial. Indeed, in view of the language contained in the prior opinion of this Honorable Court, it could scarcely have done otherwise. Was the District Court, however, bound or authorized to decide the issues as a trier of fact, upon the preponderance of the evidence? If it was, then in view of the usual presumption of correctness, the appellate test would be whether

the findings of the District Court are supported by any substantial evidence. Thus, the correctness of the appellate test contended for by Appellees rests upon a determination as to whether the Trial Court could, without a jury, apply a preponderance of the evidence test, as opposed to the usual rule on summary judgment motions.

Ordinarily, under Rule 56, Federal Rules of Civil Procedure, summary judgment may be granted only where the moving party is entitled to judgment as a matter of law and there is no genuine issue of fact remaining for trial. *Sartor v. Arkansas Natural Gas Corporation,* 321 U. S. 620, 627, 64 S. Ct. 724, 88 L. Ed. 967 (1944); *Poller v. Columbia Broadcasting System,* 368 U. S. 464, 468, 82 S. Ct. 486, 7 L. Ed. 2d 458 (1962). The moving party ordinarily has the burden of showing clearly that there is no genuine issue of fact. The function of the Trial Court is to determine whether such issue exists, not to resolve it. *Byrnes v. Mutual Life Insurance Company of New York,* 217 F. 2d 497, 9th Cir., 1954.

Appellant, in accordance with Rule 38(b), Federal Rules of Civil Procedure, demanded a jury trial both in her original and first amended complaints. This is a diversity action and, accordingly, the right to a jury trial under the Seventh Amendment to the United States Constitution is determined as a matter of Federal, rather than State, law. *Simler v. Conner,* 372 U. S. 221, 222, 83 S. Ct. 609, 9 L. Ed. 2d 691 (1963).

> "Only through a holding that the jury-trial right is to be determined according to Federal law can

> the uniformity in its exercise which is demanded by the Seventh Amendment be achieved . . ."

Ibid. at page 222.

That a party who has demanded trial by jury is entitled to a jury trial on the issue of the Statute of Limitations is not a novel proposition. *Ingo v. Koch,* 127 F. 2d 667, 2nd Cir., 1942. Where a suit is triable as of right by a jury, then a defense of Statute of Limitations which tenders genuine issues of fact is also triable as of right by a jury. *Bertha Building Corporation v. National Theater Corporation,* 248 F. 2d 833, 835, 2nd Cir., 1957.

Even though, under the provisions of Rule 42(b) of the Federal Rules of Civil Procedure, severance of an issue for separate trial be proper, such device may not be utilized to deprive a party of jury trial on the severed issue. *Marks Food Corporation v. Barbara Ann Baking Company,* 274 F. 2d 934, 936, 9th Cir., 1960.

It might be contended (and, indeed, Appellant understands this to be an unstated premise of Appellees' position) that, once the District Court resolved disputed issues of fact and disputed inferences therefrom, summary judgment became proper, as no genuine issue of fact *thereafter* remained. This, however, would authorize a Trial Court to make hearing of a motion for summary judgment a two stage proceeding. At the first stage, the Trial Court would sit as a trier of fact, divorced from any of the usual governing rules applicable to summary judgment. In the

second stage, giving lip service to the right to jury trial and Rule 56, the Court would grant summary judgment, based upon its prior fact-finding.

In *Beacon Theaters v. Westover,* 359 U.S. 500, 79 S. Ct. 948, 3 L. Ed. 2d 988 (1959), the plaintiff brought a declaratory relief action, praying a declaration that its acts were not in restraint of trade and for an injunction preventing the defendant from instituting suit. The defendant, asserting counterclaims and cross-claims for damages for restraint of trade, demanded a jury trial pursuant to Rule 38(b) of the Federal Rules of Civil Procedure. Thereafter, on plaintiff's motion, the Court severed the issues raised by the complaint, under Rule 42(b) of the Federal Rules of Civil Procedure, effectively denying to defendant the right of jury trial. The Supreme Court of the United States, upon appeal from the Court of Appeals for the Ninth Circuit, held that while the Trial Court undoubtedly possessed discretion under Rule 42(b), this discretion could not be so exercised as to deprive a party of a jury trial. *Beacon Theaters v. Westover,* supra, 359 U.S. 508.

The device attempted in *Beacon Theaters v. Westover,* supra, could not suffice to deprive a party of the right of jury trial. Certainly a two-stage summary judgment proceeding cannot be so utilized.

It may at times be difficult to determine whether a particular question is one of law or of fact. Nevertheless, where a party has a right to trial by jury upon a possible issue of fact, the courts should be extremely cautious that this right be not denied. *Cox v. English-*

American Underwriters, 245 F.2d 330, 332, 9th Cir. 1957.

This Honorable Court, in its prior opinion (342 F.2d 819) indicated that whether plaintiff's claim had accrued was a question of law. In support of this proposition, the case of *Chemung Mining Company v. Hanley,* 9 Idaho 786, 77 Pac. 226 (1904) was cited. In that case, a suit in equity seeking to establish a trust, the defendant initially demurred, setting up the Statute of Limitations. The demurrer was overruled. The answer also pleaded the statute. Thereafter, defendant moved for judgment on the pleadings. Plaintiff tendered an amended complaint. Judgment on the pleadings was granted. In reversing the judgment of dismissal, the Court stated, inter alia:

> ". . . facts which constitute a cause of action do not cease to be facts simply because of the application of the statute of limitations. When the plaintiff states his cause of action in such a manner that it appears upon the face of his pleading that the action is barred, he takes his chances of being met with a demurrer setting up the bar of the statute. In that event, he must rest upon his pleading or amend. On the other hand, if the plea is raised in the answer, *then an issue of fact arises, and he is entitled to go upon his proofs . . .*" (Emphasis supplied.)
>
> *Chemung Mining Company v. Hanley,* supra, 77 Pac. 228.

> ". . . again, when the defendant pleads in his answer that the plaintiff's cause of action is barred, the statute (Section 4217, Rev. Sp. 1887)

immediately interposes and gives the plaintiff specific denials to each and every such allegation . . . (Citations omitted) . . . *The facts constituting that bar must be proven the same as any other facts in the case . . .*" (Emphasis supplied.)

Chemung Mining Company v. Hanley, supra, 77 Pac. 228.

". . . the case stood upon complaint and answer, *and every material fact pleaded in the case was at issue, and the proofs in support of those issues should have been heard . . .*" (Emphasis supplied.)

Chemung Mining Company v. Hanley, supra, 77 Pac. 229.

The *Chemung Mining Company v. Hanley* case, supra, was a suit in equity. Therefore, it is obvious that the Court was not referring to trial by jury. However, in a jury case, the issue would be properly triable by jury. Indeed, it is noteworthy that this is precisely what would happen in those jurisdictions committed to the "Discovery Rule". See, e.g., *Tell v. Taylor,* 191 C.A.2d 266, 12 Cal. Rptr. 648 (1961); *Garlock v. Cole,* 199 C.A.2d 11, 18 Cal. Rptr. 393 (1962), in each of which the Court pointed out that the test on motion for summary judgment raising the statute was whether there existed a triable issue of fact.

This Honorable Court (342 F.2d 819) further noted that McCormick, Evidence, Section 53 (1954) emphasized the "unrealistic" nature of expecting the jury to adjudicate the questions of limitations as well as those of the merits. In view of the mandate of the Seventh

Amendment, fears that a jury might improperly decide a question are no basis for deprivation of jury trial. See, e.g., the scholarly discussion in *Ingo v. Koch,* supra.

In our Opening Brief, we cited authority that the prior opinion in this case was the "law of the case" only as to the District Court. It did not forbid questioning the correctness of certain aspects of that opinion. Without citation of any authority, each of the Appellees contends that the prior opinion is now binding. This is erroneous. *Messinger v. Anderson,* 225 U.S. 436, 444, 32 S. Ct. 739, 56 L. Ed. 1152; *Reynolds Spring Company v. L. A. Young Industries,* 101 F.2d 257, 259, 6th Cir., 1939; *Lumbermen's Mutual Casualty Company v. Wright,* 322 F.2d 759, 763, 5th Cir., 1963.

Neither the prior Appellate Opinion in this case nor the action of the District Court could properly deny Appellant her right to jury trial. The question of when Appellant's claim accrued is a mixed question of law and fact. It could not be decided by the District Court alone unless, upon motion for summary judgment, there existed no triable issue of fact. The standard which the District Court should have applied in making its ruling was whether a triable issue of fact existed. The standard which this Honorable Court must apply in reviewing the District Court's decision and its findings of fact is not whether there is some meager evidence to support the District Court's determination, but rather whether Appellees carried their burden of clearly showing that no triable issue of fact existed.

B

The Facts and Inferences Which Should Have Been Found

Appellees have gone to great length to demonstrate the correctness of all of the findings of fact rendered by the District Court. Not all of these findings were or are attacked.

The second finding, to the effect that Appellant remained, during all of the time after surgery, actively in the nursing profession, working in hospitals, is manifestly incorrect. The sole evidence on point was Appellant's testimony. Between 1952 and 1956 she did not work at all. (R.T. 114:7-20.) This second finding also is that Appellant was active in cancer prevention work. It is misleading. Her cancer prevention work consisted only of organizing volunteers and collecting money. (R.T. 183:13-25.) It certainly did not include any scientific studies or the acquisition of any degree of expertise in the field of pathology.

The tenth finding of fact, to the effect that the tissue section slides are now deteriorated to some degree, is misleading. There was testimony that Appellee McCarter was able, a few weeks prior to hearing, to reach a diagnosis from examining the slides. (R.T. 254.) To the extent that this finding indicates prejudice to Appellees, it errs by not including the undeniable fact that diagnosis is still possible from these slides.

The twelfth finding of fact, to the effect that Appellant did not rely solely on Dr. White for medical advice and treatment, and that there was not a continuing relationship of doctor and patient, is incom-

plete and misleading. The testimony was that, in the field of cancer, more particularly in relation to her particular medical situation vis a vis the breast surgery, Appellant relied upon Dr. White and his advice until she consulted Dr. Shaw in 1962.

At pages 23 through 25 of Appellant's Opening Brief, we set forth the reasons why Appellant's proposed findings of fact numbered 2, 3, 11, 12, 13, 20, 22 and 23 should have been adopted. Without reiterating here the evidence in support of those proposed findings, it should be stressed that they do not, as contended by Appellees in their briefs, constitute mere quibbles. Rather, these findings would have made clear that Appellant had trust and confidence in her doctors, that she was neither equipped nor competent to read tissue section slides, nor to act as a pathologist or diagnose cancer. Further, these proposed findings would have emphasized the fact, admitted by Appellee White in his testimony, that he stressed to Appellant that she had had cancer and, indeed, advised the thyroidectomy because of her prior history of cancer. Further, these proposed findings would have established that Appellant had no notice of the misdiagnosis until she was advised by Dr. Shaw in 1962.

Application of the proper evidentiary test at the District Court level, coupled with application of the proper appellate test, would bring before this Honorable Court a fact pattern showing the following:

(1) Appellant submitted to a radical mastectomy, upon advice of Appellees, believing that she suffered from cancer.

(2) Appellant submitted to extensive radiation treatments, believing that she had cancer.

(3) Appellant was not qualified or competent to read the tissue section slides from which the misdiagnosis of cancer had been made.

(4) Appellant was repeatedly told by Appellee White that she had cancer.

(5) In 1962, solely in connection with a change of doctors by Appellant, Dr. Shaw caused the tissue section slides to be re-read by a qualified pathologist.

(6) In 1962, upon re-reading, it was discovered that the tissue section slides did not reveal the existence of cancer.

(7) This was the first notice which Appellant had that the original diagnosis and reading of the slides was in error.

(8) All of the doctors who participated in the original diagnosis and surgery are living and available to testify.

(9) All records, reports, etc., of the original diagnosis and surgery are available.

(10) The tissue section slides are somewhat deteriorated, but are in sufficiently good shape that Appellee McCarter was able to reach a diagnosis from them in May or June of 1965.

The fact pattern above referred to completely vitiates any argument that Appellant slept upon rights (the existence of which were unknown to her) or that there

is any prejudice to the Appellees sufficient to warrant denial to Appellant of her day in court.

For the reasons set forth above, it is very respectfully submitted that the District Court applied an erroneous standard of proof, that the appellate test contended for by Appellees is erroneous, that Appellant was deprived of her right to jury trial and that, accordingly, the judgments rendered below cannot stand.

II

THE TRIAL COURT APPLIED AN ERRONEOUS LEGAL STANDARD IN DETERMINING THE APPLICABILITY OF THE "DISCOVERY RULE"

In our opening brief, at pages 28 and 29, we pointed out that the District Court had specifically concluded as a matter of law:

> "That plaintiff *could* have by exercise of due diligence, discovered the alleged malpractice at any time after the surgery and treatment complained of." (Emphasis supplied)

The governing Idaho law, as contained in *Billings v. Sisters of Mercy of Idaho,* 86 Idaho 485, 389 P.2d 224 (1964) is:

> ". . . the cause of action does not accrue until the patient learns of, or in the exercise of reasonable care and diligence *should* have learned of . . . the alleged malpractice." (Emphasis supplied)
>
> *Billings v. Sisters of Mercy of Idaho,* supra, 389 P.2d at 232.

Appellee St. Luke's (Brief, p. 31) contends that the difference between the Idaho standard and that applied by the District Court is a mere quibble Not so.

The District Court's seventh finding of fact was:

> "That plaintiff knew at all times that the defendant hospital records and the slides on which the diagnosis was predicated were available for her examination at her simple request."

The eighth finding of fact was:

> "For a period of eleven years from the date of the surgery, she made no investigation to determine the accuracy of the diagnosis on which the surgery was based."

Nowhere in the District Court's findings of fact is there any finding that Appellant, prior to 1962, knew or suspected that Appellees' original diagnosis of cancer had been in error. Nowhere did the District Court find any fact to have been communicated to her prior to 1962 which put her on notice or required investigation. The difference between "could" and "should" is material; the District Court believed that if Appellant *could* at any time have asked for an independent pathological review of the tissue section slides, this was sufficient to bar her claim.

There has never been any assertion by Appellant that it was impossible for her to have the slides read by an independent pathologist. It was always possible. But there was no reason for her to make the request. The test as to whether a plaintiff is put upon inquiry

is not whether an inference of the defendant's negligence could conceivably have been drawn from the data available, but whether, from that data, there arose a conclusion of negligence which a reasonable person would be *required* to reach. *Bowman v. McPheeters,* 77 C.A.2d 795, 802, 176 P.2d 745 (1947). The test is whether, upon the facts known to plaintiff, a prudent person would believe there to be cause for investigation. *Mock v. Santa Monica Hospital,* 187 C.A.2d 57, 66; 9 Cal. Rptr. 555 (1960).

The same rule is applied in *Hundley v. St. Francis Hospital,* 161 C.A.2d 800, 327 P.2d 131 (1958), cited and relied upon by this Honorable Court in its prior opinion. (242 F.2d at 820). Plaintiff's ovary and fallopian tube were removed because of a diagnosis of cancer, which diagnosis was negligently incorrect. Following verdict and judgment for plaintiff, defendant appealed, contending that the statute of limitations had run. One of the bases for affirmance was that knowledge of the misdiagnosis had not come to plaintiff until within the statutory period. Parenthetically, in this case, the issue of limitations had been left, in accordance with the law in "Discovery Rule" states, to the jury.

Examining the District Court's findings of fact, matching them to the conclusions of law and the decision rendered, the conclusion is inescapable that the District Court believed that it was sufficient to bar Appellant's claim that she was physically able to obtain the tissue section slides. This is not the rule. Appellant's claim did not accrue until she possessed

knowledge or information which would require a reasonably prudent person to believe that there had been a negligent misdiagnosis. The difference between the proper rule and that applied is no mere quibble; it is the heart of the case.

III

THE TRIAL COURT ERRED IN GRANTING THE MOTION TO DISMISS

Appellees have each contended that the prior appellate opinion in this case (342 F.2d 817) is the "law of the case". Each has advanced this argument without citation of authority. Each is in error. The authorities and the correct rule are set forth in our argument under the first subheading.

In our Opening Brief, at pages 35 through 52, the "Discovery Rule" as developed in states other than Idaho, was extensively analyzed. Uncontroverted by Appellees herein, that analysis will not now be repeated.

This Honorable Court, in its prior appellate opinion, held that Idaho would apply the "Discovery Rule" to medical malpractice cases outside the foreign object field. The District Court, at least, apparently interpreted this opinion as indicating, however, that factors listed in the prior opinion (342 F.2d at 820) such as the continuing relationship of doctor and patient, prejudice to the defendant, relative difficulty of proving the wrong, and availability of witnesses

and records would be considered in determining whether the "Discovery Rule" should be applied. In our Opening Brief, the Court's citations of authority were analyzed to show that these were all factors which operated *within* the "Discovery Rule", rather than in determining whether to apply it.

Counsel's research has unearthed no "Discovery Rule" decision in which a reasonably diligent plaintiff, first on notice of the doctor's negligence within the prescriptive period, has been barred.

For the first time on appeal, Appellee St. Luke's (Brief, p. 33) contends that the initial advice by Appellee White that there was no cancer, followed by his statement a day or two later that there was cancer, should have alerted anyone to the danger of negligence. Further, it is contended that the advice that the tissue removed during the radical mastectomy contained no malignant cells gave Appellant "constant notice that the diagnosis might be wrong".

Appellee White actually testified as follows:

> "Q. Do you recall whether, following the biopsy, you did in fact tell the plaintiff that there was no malignancy? That is to say, it looked like it was benign, the lesion?"
>
> A. I told the patient after she recovered from the anesthesia, etc., that gross examination of this tissue removed by biopsy, that is, the tumor mass per se, that it appeared to be benign, but that we would have to wait until the microscopic sections were in, as routine surgical practice in any institution, in order to have a final diagnosis."
>
> (R.T. 194:8-17).

Appellee White later, in accordance with the report of the tissue section analysis, told Appellant that the tissue removed by biopsy was malignant. This would in no way serve to alert her to possible negligence.

It is asserted that the lack of malignancy in the tissues removed in the radical mastectomy should have alerted Appellant to possible negligence. Appellees offered no testimony indicating or tending to indicate that such lack of malignancy would indicate error in the original diagnosis. Further, the assertion ignores the testimony of Appellant that Appellee White told her, following the radical mastectomy, that it appeared that they had gotten all of the malignant tissue. (R.T. 116:13-25.) It ignores Appellee White's testimony that he told Appellant that she had cancer.

It is useless to debate terms such as "due diligence" and "unconscionable delay" based upon a record which shows no fact which would or could have made Appellant suspect the negligence of Appellees. It would be a strange rule indeed—and stranger still when contended for by representatives of the medical profession—that required the patient to constantly question the judgment of her doctors; that required a patient upon leaving the care of one doctor to ask the next for an investigation to ascertain possible negligence by the first. Such a rule would destroy every conceivable and rational foundation for a fruitful doctor-patient relationship.

Lastly, Appellee St. Luke's (Brief, p. 8) complains that no notice of claim was given to any of the Appellees prior to filing of suit. No authority has been cited

that such a claim is necessary. Nevertheless, it is instructive to notice that Appellee McCarter, the pathologist, did receive a letter from Dr. Shaw setting forth the Stanford Medical School diagnosis in 1962. (R.T. 73:15-25; Exhibit 9.) Appellees objected to any testimony as to whether the contents of that letter were communicated by Dr. McCarter to any of the other Appellees. As far as the evidence reveals, Appellee McCarter did, in response to this letter, exactly nothing, i.e., precisely what Appellees criticized Appellant for having done up until the time she was informed that the original diagnosis was wrong.

It is very respectfully submitted that the only proper standard to be followed in ruling on a motion for summary judgment in this case was: there being disputed inferences from undisputed facts and a dispute as to the facts themselves, the motion should have been denied. *Tracerlab, Inc. v. Industrial Nucleonics Corporation,* 313 F.2d 97, 1st Cir. (1963); *R. J. Reynolds Tobacco Company v. Hudson,* 314 F.2d 776, 5th Cir. (1963); *Sheets v. Burman,* 322 F.2d 277, 5th Cir. (1963).

Even on the factors found by the District Court, there was no lack of diligence, no fact or circumstance which required Appellant to do anything more than, as a good patient, rely upon the original advice of her doctors.

Idaho would apply the "Discovery Rule" outside the foreign object field. Appellant falls well within the ambit of that rule. The District Court's failure to afford to Appellant the benefit of that rule constituted prejudicial error.

CONCLUSION

It is very respectfully submitted that Appellant herein was denied her right of trial by jury, that an erroneous standard of proof was applied, that a material error as to the applicable law was made and that, on the record before this Honorable Court, the judgment rendered below cannot stand and must be reversed.

Dated, San Francisco, California,
June 9, 1966.

Respectfully submitted,
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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

FREDERICK A. CONE.

No. 20591

United States Court of Appeals

FOR THE NINTH CIRCUIT.

REDERI A/B SOYA, as owners of the Swedish Motor Vessel *OTELLO*,

Appellant,

vs.

The SS. *GRAND GRACE*, her Engines, etc., and her Owners, GRACE NAVIGATION CORPORATION,

and

The MV *JANE STOVE*, her Engines, etc., and her Owners, LORENTZENS SKIBS A/B,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT, FOR THE DISTRICT OF OREGON, HONORABLE JOHN F. KILKENNY, DISTRICT JUDGE.

APPELLANT'S BRIEF.

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No. 20591.

United States Court of Appeals

For the Ninth Circuit.

Rederi A/B Soya, as owners of the Swedish motor vessel *Otello*,

Appellant,

vs.

The SS. *Grand Grace*, her engines, etc., and her owners, Grace Navigation Corporation,

and

The M/V *Jane Stove*, her engines, etc., and her owners, Lorentzens Skibs A/S,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON, HONORABLE JOHN F. KILKENNY, DISTRICT JUDGE.

APPELLANT'S BRIEF.

Jurisdiction.

This case arises under the admiralty and maritime jurisdiction of the United States and the Appellate Jurisdiction of this Court. (U. S. Constitution, Art. III §2; 28 USCA §1333, 28 USCA §1291.) On September 10, 1965, the owners of the M/V *Otello* duly filed a timely notice of appeal (R. 131), from a final decision and decree by District Judge Kilkenny in this matter in the District Court for the District of Oregon (R. 124).

Statement.

This case involves a collision between the Swedish M/V *Otello* and the Liberian SS. *Grand Grace* which occurred on January 19, 1964 in the Columbia River near Astoria during a gale force wind. A third vessel, the Norwegian M/V *Jane Stove* has been charged by both colliding vessels with interfering with the navigation of the *Otello,* thereby contributing to the collision.

Statement of facts.

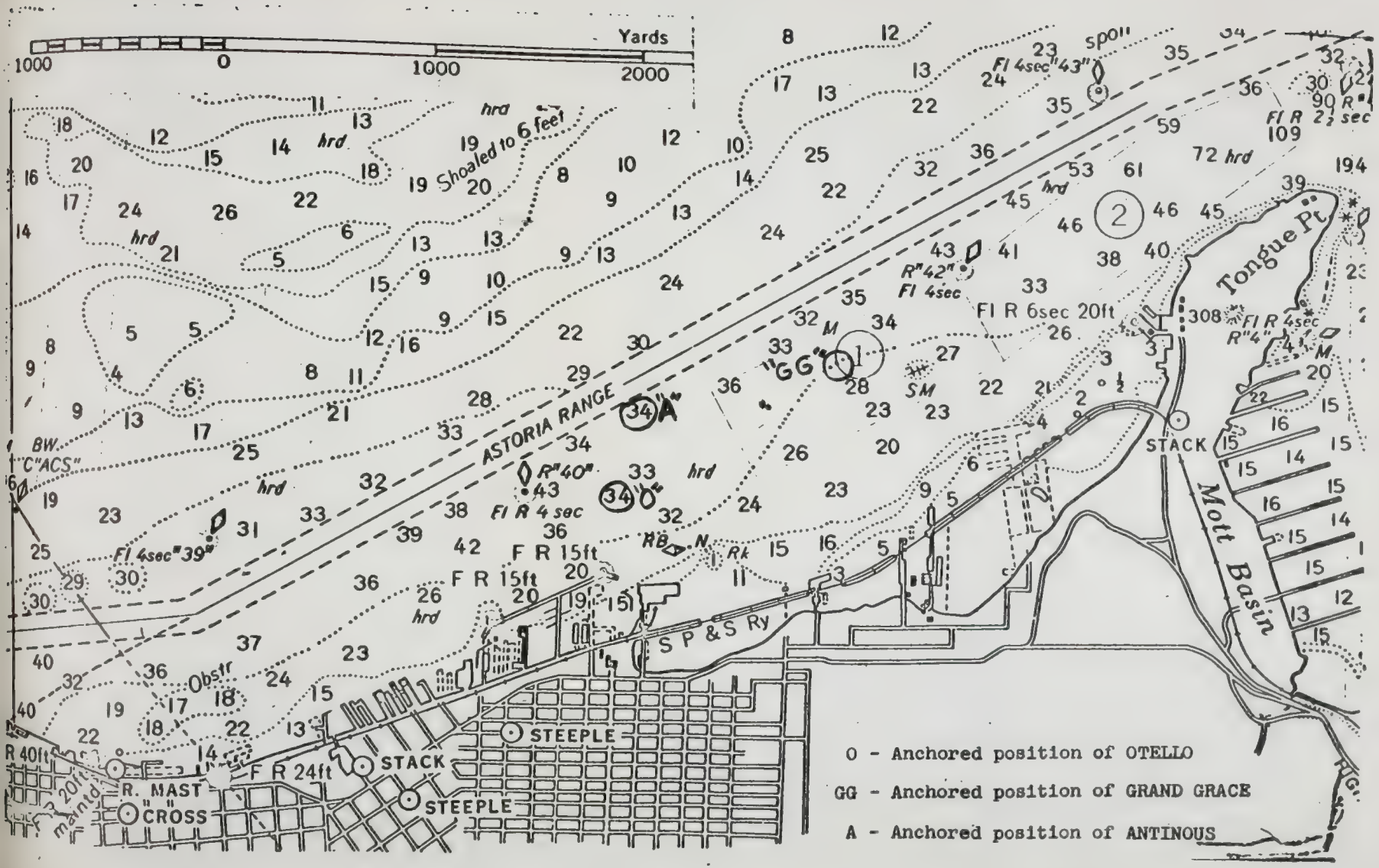
On January 17, 1964, the *Otello* anchored off Astoria, south of the main ship channel, in a location about midway between buoy 40 and the red and black nun buoy to the southeast (R. 340). The *Otello* had anchored in this position with five shackles of chain (450 feet) on her port anchor, in accordance with the local pilot's recommendations (R. 331). The *Otello's* anchor bearings were checked carefully on every watch (R. 344-345, 475, 524).

On the attached page is a photocopy of the pertinent harbor area, showing the stated anchored position of the *Otello,* marked with the letter "O".

On the morning of January 19, 1964, the *Mary Olsen,* a lumber barge, came to anchor about three hundred feet off the *Otello's* port quarter (R. 487). The American cargo vessel, *Antinous,* anchored about five hundred feet northward and slightly further upstream on the *Otello's* starboard side and south of the main ship channel (R. 487). The *Grand Grace,* which ultimately was in collision with the *Otello,* was anchored about one-quarter to one-half mile astern of the *Otello* (R. 487).

The stated position of the *Grand Grace* is shown on the photocopy above mentioned, by the letters "GG".

Weather reports received by the *Otello* for January 19 predicted that there would be winds from 35 to 50 knots (Ex. 8C). At 2:00 p.m. the officers aboard the *Otello* noted that the wind was westerly force nine to twelve, and at 3:00 p.m. the wind had increased to force 10 to 12, from the same direction (Ex. 4D). According to the official


Yards
1000
0
1000
2000
Shoaled to 6 feet
ASTORIA RANGE
Fl 4sec "43"
R"42"
Fl 4sec
Fl R 6sec 20ft
Fl R 4sec
R"40"
Fl R 4 sec
Fl 4sec "39"
F R 15ft
F R 24ft
Obstr
S P & S Ry
STEEPLE
STACK
R. MAST
CROSS
Tongue Pt
Mott Basin
O - Anchored position of OTELLO
GG - Anchored position of GRAND GRACE
A - Anchored position of ANTINOUS

Beaufort scale, wind force 9 consists of winds of 41 to 47 knots, and force 12 consists of winds over 65 knots. An alert watch was maintained aboard the *Otello* during this period to check her position.

At about 2:30 p.m. the *Otello's* Master and Third Mate observed that the *Otello* was moving closer to the barge *Mary Olsen*, and it was determined that the *Otello* was dragging (R. 166-167). The *Otello* immediately began sounding her whistle for a pilot, so that she could be moved to a new anchorage position (R. 166-168). Shortly thereafter the *Otello's* engines were ordered on "stand-by" (R. 677). Being a motor vessel, the *Otello* could put her engines to use immediately if required (R. 683).

After futilely waiting about fifteen minutes for a pilot, the *Otello* commenced maneuvering her twin engines in an effort to maintain her position (R. 677-678), and the Mate and Carpenter, who had previously been ordered to report to the bow, were ordered to commence heaving up the anchor (R. 202-203). It was intended to move forward, pick up the anchor, move back to or beyond the original anchored position, and then let go both anchors (R. 176). Prior to this time, there had been no need for the *Otello* to use both anchors. After she started dragging, such an action would have been ineffective unless and until the *Otello* was able to move ahead by her engine power back to her original anchored position, where the second anchor could then have been put out (R. 242).

After the *Otello*, assisted by her engines, had heaved in about two shackles of chain (180 feet), the chain caught across her sharp bow, thus preventing the crew from heaving in any more chain. The wind swung the *Otello's* bow to starboard and she began dragging in an easterly direction upstream with her portside exposed to the westerly wind (R. 178). Efforts to head the *Otello* into the wind by the use of her engines and helm were futile (R. 206). As the *Otello* dragged past the *Antinous*, her master decided he would work the *Otello's* engines ahead and steam northward, to the open water north of the main channel, once the *Otello* had cleared the *Antinous* (R. 179). At this point,

the M/V *Jane Stove* was observed approaching, at high speed, on a course between the *Antinous* and the *Otello* (R. 179-184). The *Otello* stopped sounding pilot signals and commenced sounding danger signals (R. 179-180).

The *Jane Stove* disregarded the *Otello's* danger signals and proceeded through the anchorage, across the bow of the *Otello*, at an undiminished speed (R. 185). The *Jane Stove's* negligent action forced the *Otello* to stop her engines and then go astern, to avoid a collision with the *Jane Stove* (R. 221, 222, 247). This maneuver prevented the *Otello* from proceeding into the open waters north of the main channel and placed her at the mercy of the wind, which was setting her down on the *Grand Grace* (R. 198, 199).

The officers of the *Grand Grace* had observed the predicament of the *Otello* from the beginning (nearly an hour before), but made no effort whatsoever to avoid the collision between the two vessels (R. 837-838, 1182-1183, 843). The *Grand Grace* made no use of her rudder to sheer the vessel away from the *Otello* (R. 843), as the nearby *Antinous* successfully did (R. 1647), nor did the *Grand Grace* pay out more anchor chain (R. 842), either of which would have avoided the collision. Nor did the *Grand Grace* make any effort to ready her engines to aid her in maneuvering out of the way (R. 843).

Finally, at about 3:23 P. M., the after starboard side of the *Otello*, just after the *Jane Stove* cleared the *Otello's* bow, came into contact with the bow of the *Grand Grace*, at an angle of about 90 degrees (App. A p. 31). As a result of the collision, the *Otello* suffered damages in the amount of $96,933.13.

The proceedings.

On January 22, 1964, Rederi Soya, as owner of the *Otello*, filed a libel in the District Court for the District of Oregon naming the SS. *Grand Grace* and her owners and the M/V *Jane Stove* and her owners as respondents, alleging that the negligence of these vessels caused damage

to the *Otello* (R. 1). On January 23, 1964, the owners of the *Grand Grace* filed an answer and cross libel against the *Otello* and *Jane Stove*, charging that both vessels negligently caused damage to the *Grand Grace* (R. 6). On March 23, 1964, the owners of the *Jane Stove* filed an answer denying the allegations of fault made by the other vessels against the *Jane Stove* (R. 35).

The consolidated suits were heard by the District Court of Oregon, which rendered a memorandum decision (R. 73), dismissing with prejudice the libel of the owners of the *Otello* against the *Grand Grace* and *Jane Stove*, and holding the owners of the *Otello* liable to the owners of the *Grand Grace* for the damages alleged in the *Grand Grace* cross libel. On January 5, 1965, Judge Kilkenny signed proposed findings of fact and conclusions of law submitted by the proctors for the M/V *Jane Stove* and the SS. *Grand Grace* (R. 75). On July 19, 1965, the Court rendered a final decree in this matter (R. 124-126), wherein it awarded to the owners of the *Grand Grace* damages for injury to the *Grand Grace*, plus interest, taxable costs and "litigation expenses". The owners of the *Jane Stove* were awarded "litigation expenses", interest and taxable costs. On the same date, the owners of the *Otello* filed a notice of appeal from this decision (R. 131-132).

Errors.

Appellant submits that the trial court erred in the following respects:

1. The Trial Court ignored the deposition testimony of the *Jane Stove's* officers and crew, showing that she boxed in the *Otello* and interfered with her navigation which refuted the claims of the *Jane Stove's* self-interested pilot.

2. The Trial Court overlooked the fact that the *Grand Grace's* testimony, all taken by deposition, admitted that her officers did nothing to prevent the

collision, although aware of the *Otello's* predicament for a considerable period of time before the collision.

3. The Trial Court's ultimate liability conclusion is contrary to the testimony describing the collision contained almost entirely in the approximately 40 depositions of ship's witnesses introduced in evidence.

4. None of the depositions, constituting virtually all of the testimony, nor the many exhibits were read to or described to the Trial Court, at his suggestion and upon his assurance that he would study them carefully, which apparently was not done.

5. The Trial Court ignored the fact that the *Otello's* dragging was caused solely by sudden and extremely high winds.

6. The Trial Court erred in failing to draw the necessary adverse inferences from the *Grand Grace's* failure to produce her Master or Pilot at the trial, or to take their *de bene esse* depositions.

7. The Trial Court's opinion did not comply with the letter or spirit of the Supreme Court Admiralty Rule 46½ in that it contained no analysis of the facts or law, gave no reasons, and stated only ultimate conclusions.

8. The Trial Court merely "rubber stamped" findings of fact and conclusions of law jointly submitted by proctors for the *Grand Grace* and the *Jane Stove*, more than two months after the opinion was filed, without affording appellant the prior opportunity to review them or to submit counter proposals.

9. The Trial Court erred in allowing litigation expenses.

Argument.

Summary.

It is to be noted at the outset that the Trial Court failed to comply with the dictates of the Supreme Court Admiralty Rule 46½ in rendering its decision. The requirement that a court "find the facts specially and state separately its conclusions of law thereon" is to be followed if a court is to make a decision vested with due process. The underlying harm to a litigant which inevitably stems from a disregard of this rule is clearly present in this case.

The fact that the lower Court adopted the prevailing parties' proposed findings of fact and conclusions of law *in toto* raises doubts that these findings were independently determined by the Court in arriving at its decision. It is consistently held that an appellate Court will scrutinize such findings very closely. *Infra,* Point I, p. 8 *et seq.*

The basic issues involved in this case were whether or not any or all of the vessels named as parties were negligent. We submit that the lower Court's finding of negligence by the *Otello* and lack of negligence by either the *Grand Grace* or *Jane Stove* is erroneous. The lower Court failed to find facts justifying a conclusion of fault on the part of the *Otello* or its absence in the case of the *Grand Grace* and the *Jane Stove.*

We submit that the trial Court's findings of facts 15 through 23 are clearly erroneous because they totally ignore the deposition testimony of the Master and watch officer of the *Jane Stove* and the Master and Watch Officer of the *Grand Grace.* Furthermore, the Court failed to draw any adverse inferences from the non-production of either the Master or the Pilot of the *Grand Grace* for either *de bene esse* depositions or trial testimony. This case is based mainly on depositions rather than trial testimony, which leaves this Court in as good a position to determine the issues as the trial Court.

In its final decree, the lower Court awarded the prevailing parties "litigation expenses". We submit that such award is totally at odds with American jurisprudence, and insupportable in either law or fact.

POINT I.

The trial court did not comply with Supreme Court Admiralty Rule 46½ in rendering its decision (specification of errors 7 and 8 above).

Supreme Court Admiralty Rule 46½:

> "In deciding cases of admiralty and maritime jurisdiction the court of first instance shall find the facts specially and state separately its conclusions of law thereon; and its findings and conclusions shall be entered of record and, if an appeal is taken from the decree, shall be included by the clerk in the record which is certified to the appellate court under rule 49. Added June 2, 1930, eff. October 1, 1930."

Decisions condemn certain courts' practices of simply "parroting" findings of fact and conclusions of law submitted by the prevailing party as being violative of Rule 46½.

In *The Severance*, 152 F. 2d 916, 918 (4th Cir. 1945), a steamship under tow collided with a barge piling. Suits were brought by the vessel's owner and cargo against the tug, and judgment was rendered for the respondent tug. The judge did not file an opinion, but simply advised the parties by mail that he found no fault by the respondent tug. The trial judge then adopted, virtually *in toto*, the proposed findings and conclusions of law submitted by the respondent tug. The Circuit Court reversed and remanded. Circuit Judge Dobie stated at p. 918:

> "No opinion was filed by the District Judge, who wrote to the proctor for respondents that the District Judge found the respondents without fault and therefore relieved of liability. In this letter the District Judge requested the proctor for respondents to present findings of fact and conclusions of law. The District Judge then, practically *in toto*, adopted these findings and conclusions.
>
> "1 This practice is not to be commended. It has been condemned by many courts as not living

> up to the provision of Admiralty Rule 46½, 28 U. S. C. A. following section 723: 'In deciding cases of admiralty and maritime jurisdiction the court of first instance shall find the facts specially and state separately its conclusions of law thereon.' See Irvine *v.* The Hesper, 122 U. S. 256, 7 S. Ct. 1177, 30 L. Ed. 1175; Petterson *v.* New York Central R. Co., 2 Cir., 126 F. 2d 992; Schilling *v.* Schwitzer, 79 U. S. App. D. C. 20, 142 F. 2d 82; City of New York *v.* McLain Lines, 2 Cir., 147 F. 2d 393; Chicago, D. & G. B. Transit Co. *v.* Moore, 6 Cir. 259 F. 490."

The lower Court's memorandum decision, and subsequent findings of fact and conclusions of law are clearly neither within the letter nor the spirit of Supreme Court Admiralty Rule 46½. The memorandum decision, in essence, simply states the broad conclusions that the owners of the *Otello* had failed to sustain their burden of proof, whereas the owners of the *Grand Grace* had met their burden of proof as to certain contentions enumerated in their pre-trial order. We submit that the Court failed to "find the facts specially and state separately its conclusions of law thereon", but simply made a general statement as to liability without any specification of facts in support of his conclusions.

A decision, such as here, based upon findings of fact and conclusions of law submitted by the prevailing party, is not entitled to the same weight and dignity which an independent and unfettered judgment would receive on appeal. In *The Severance, supra*, Judge Dobie stated at page 918:

> "* * * We content ourselves by observing that these findings of fact and conclusions of law are not, at our hands, entitled to the same weight and dignity which they would have possessed had they represented the unfettered and independent judgment of the trial court."

In *Mesle* v. *Kea Steamship Corporation*, 260 F. 2d 747, 750 (3d Cir. 1958), *cert. denied*, 359 U. S. 966, Circuit Judge McLaughlin states at page 750:

> "* * * And yet where the court has not independently set out its findings we think the reviewing court may more readily be * * * 'left with a definite and firm conviction that a mistake has been committed' ". (Citation omitted.)

Circuit Judge Rives stated in *Kinnear-Weed Corp.* v. *Humble Oil & Refining Co.,* 259 F. 2d 398, 401 (5th Cir. 1958), *cert. denied,* 361 U. S. 930, at p. 401 as follows:

> "* * * Nevertheless, we must say that findings and conclusions which represent the independent judicial labors and study of the district judge are more helpful to this court."

Circuit Judge Wisdom stated in *Louis Dryfus and Cie* v. *Panama Canal Co.,* 298 F. 2d 733, 737, 738, 739 (5th Cir. 1962), at page 738, as follows:

> "When the findings have been drafted by the trial judge himself, they carry a certain badge of personal analysis and determination that may dissuade an appellate court from reversing in a doubtful case. When that badge is missing, the appellate court can feel slightly more confident in concluding that important evidence has been overlooked or inadequately considered—if the evidence supporting the decision is of a doubtful nature."

We submit that in the present case the lower Court simply adopted the self-serving, slanted findings of fact and conclusions of law submitted by the prevailing parties. The failure to show any clear and independent analysis of the facts and law in this case raises serious doubts as to the soundness of the decision. We submit further that the circumstances warrant scrutiny by this Court of the case, to prevent substantial injustice resulting from the failure of the Trial Judge to render an independent and unfettered judgment.

POINT II.

The trial court's findings of fact as to the *Otello* and the vessels she charges are clearly erroneous (specification of errors 1 through 6).

The errors with respect to the *Otello*.

In judging whether a particular action was negligent, a court should naturally view the facts and fix responsibility in the light of the circumstances confronting the parties at the time. Cf. *Petterson* v. *New York Central R. Co.*, 126 F. 2d 992, 994 (2d Cir. 1942); the *Queen Elizabeth*, 122 F. 406, 409 (2d Cir. 1903). When thus viewed, if it appears that a navigator acted within the limits of reasonable discretion, his action should not be condemned, even though, in the light of knowledge after the event, it appears that he might have chosen a more successful course. The *Queen Elizabeth, supra;* the *Clarence L. Blakeslee*, 243 F. 365 366 (2d Cir. 1917); the *Hugh Kylees*, 73 Fed. 255, 259 (2d Cir. 1896). We submit that the lower Court applied at best superficial considerations to the actions of the *Otello*, without regard for the realities which confronted her throughout. If the actions of the *Otello* are judged on a proper basis, her actions cannot be condemned.

The *Otello* had been safely and securely anchored on one anchor for two days prior to the collision (R. 164-166). There was no prior warning that the winds which ultimately caused the *Otello* to drag would be of such great intensity (Ex. 8C). Had the *Otello* let out more chain when she discovered she was dragging, she would have placed herself in dangerously close proximity of the lumber barge, the *Mary Olsen* (R. 242). Once she began to drag her first anchor, it was futile to let go a second anchor, since this would still have left her perilously close to the *Mary Olsen* (R. 242). The *Otello* began dragging without warning, thus there was no apparent need to ease the strain on the anchor chain prior to her dragging. Once it was observed that the *Otello* was dragging,

her twin engines were used to ease the strain on her anchor chain (R. 204). The Court below, according to Finding of Fact 16(l) would have had the *Otello* remain quiescent, dragging helplessly toward the *Grand Grace,* rather than attempt to navigate out of the crowded anchorage to the relative safety of the open waters to the north of the main channel.

Finding of Fact 16(g) ignores the uncontroverted fact that the *Otello* was overcoming her gale-induced dragging predicament and was in fact navigating effectively out of the anchorage into the fairway, but was prevented because the *Jane Stove* heedlessly "crowded" and blocked her (R. 198). A proper lookout was maintained at all times on the *Otello,* since at least one licensed officer and one seaman were on the bridge at all times, and at least one man was on the bow during the period when the *Otello* was approaching the *Grand Grace* (R. 176).

Finding of Fact 16(i) disregards the uncontroverted fact that the *Otello* did use her engines to maneuver away from the *Grand Grace.*

Captain Sundlof, the Master of the *Otello,* testified (R. 207), that he was in fact moving with ahead power out of the anchorage and away from the *Grand Grace* before he was crowded by the *Jane Stove.*

> "The Court: What application of power were you making at that time, Captain?
>
> The Witness: We went slow ahead on starboard engine. And we were approaching *Antinous* all the time, came closer and closer to *Antinous.*
>
> The Court: That is on account of your drift or drag?
>
> The Witness: Also the speed.
>
> The Court: Your drag?
>
> The Witness: Yes, and the speed we made. We went slow ahead on starboard.
>
> The Court: Proceed."

Chief Mate Sven J. Lindstrom described the reckless approach of the *Jane Stove* (R. 427):

> "Q. Did you continue to watch her after that time? A. Yes, I did.

Q. What direction was she heading with relation to the bow of the *Otello?* A. Right straight in front of our bow.

Q. Where were you standing during this time when you watched the *Jane Stove?* A. On the fo'c's'le.

Q. At this point that you have indicated with an X right at the bow, on Exhibit 1, that is? A. Yes.

Q. How close did the *Jane Stove* pass in front of the point on the bow where you were standing? A. 20-25 meters."

The errors with respect to the *Grand Grace*.

The evidence of the *Grand Grace* shows that her officers admittedly observed the difficulties of the *Otello* for nearly an hour and made no effort to take measures which would have avoided a collision. The *Grand Grace* evidence shows that she made no effort to ready her engine for maneuvering during the fifty minutes that the *Otello* dragged toward her. (Finding of Fact 16(k) states the *Otello* was in difficulty for fifty minutes.) The evidence also shows that the *Grand Grace* made no effort to let out chain or to sheer away from the *Otello* by means of her rudder or engines (R. 837-838, 893, 1182-1183), although it is a well-recognized practice, and in fact was accomplished by a nearby ship, the *Antinous*.

The *Otello* was first observed to be dragging toward the *Grand Grace* at around 2:30 P. M. by the bridge watch of the *Grand Grace* (R. 1281) and was under constant observation by the *Grand Grace* until the collision occurred at 3:23 P. M. (Ex. 4D).

Lin Ping Kuei who was acting as lookout on the *Grand Grace,* testified (R. 1281):

"Q. When were you first aware that the *Otello* was moving down towards your ship? A. I don't remember the exact time, but possibly—it is approximately around 2:30, but I cannot be exact.

Q. And did you continue to watch the *Otello* from that time? A. Yes, of course, I noticed them. They were coming towards us."

Captain Sha of the *Grand Grace* acknowledged that he observed the *Otello* dragging toward his vessel, and that a

perilous situation was developing. At the discovery depositions he drew a diagram, which graphically portrays how he observed the *Otello* slowly drag toward the *Grand Grace* (A p. 31). Sha stated (R. 837):

> "Q. Now, Captain, when you saw this vessel in position No. 2 about ten minutes before the collision —that is correct, isn't it, Captain? A. That's right.
>
> Q. From the time that you saw the vessel in that position No. 2, did you watch her all the time? A. I watch her all the time and I called attention to Captain Wang and the third mate.
>
> Q. And they were on the bridge with you? A. They also were there. I say, 'Watch that fellow. We may get trouble.' "

At page 841, Captain Sha states:

> "Q. Captain, as the *Otello* moved from position 2 to 3 to 4, were you watching her constantly? A. Watching.
>
> Q. Was the captain, the former captain, watching her constantly? A. Yes. All on the bridge watching.
>
> Q. And the third mate also was watching? A. Yes.
>
> Q. I suppose everyone was concentrating on her? A. Oh, yes, if any accident happen.
>
> Q. Were you watching any other ships in the anchorage area at that time? A. No, all concentrating on that ship."

Despite the fact that officers on the bridge of the *Grand Grace* were supposedly observing the approach of the *Otello* for nearly an hour, and recognized that there was danger of collision, no attempt was made to veer chain, use the rudder, or prepare the engines for maneuvering. Mr. Sha states at page 842 of the record:

> "Q. Did you order any engine movements at all prior to the collision? A. Before?
>
> Q. Before the collision. A. Before collision, no, the engines are not stand by.

Q. And you did not put them slow ahead or anything like that, before collision? A. No, no movement of engines.

Q. Did you let out any additional anchor chain before the collision? A. You mean the fairway anchor cable?

Q. In other words, you had five shackles out. Did you let any additional chain out? A. No, at no time.

Q. Were there people on your bow who could have let the anchor chain out? A. At that time, no people on the bow."

Capt. Sha at page 843:

"Q. Did you have a helmsman on duty before the collision? A. Yes, an A/B on duty.

Q. Was he in the wheelhouse? A. Yes.

Q. Did you give him any orders before the collision? A. No."

The neglectful inaction of the *Grand Grace* is clear when compared with the efforts of the American freighter *Antinous*, which was also anchored near the *Otello*. When the *Otello* began to drag, and approached the *Antinous*, her Master alertly maneuvered his engines and sheered his rudder so as to swing his anchored vessel clear of the *Otello*. Captain Pullen, Master of the *Antinous*, states at page 1647 as follows:

"A. Well, the only thing is that I felt very sorry. I was wondering what I could do to help her out, especially when she blew the danger signal, I thought she was blowing at me. And with the anchor down and so forth, and without me getting involved, I just thought I would swing over and give her as much room as my ship would swing without going ahead, so I gave her left rudder, and we gave her a few more revolutions I think probably, because at that time we were turning as much as twenty to give her a little rudder, to get her a little rudder power."

Knight's *Modern Seamanship*, 13 ed. p. 152, the accepted "Bible of Seamanship", is significant in this respect:

"If a vessel or other danger is seen drifting down upon you when lying at anchor or in a tide way,

> by giving the ship a cant with the rudder, thus bringing the current on the bow, and bearing the chain roundly you may sheer well over across the tide and probably be clear of danger."

Neither Captain Sha nor the pilot of the *Grand Grace* were produced as witnesses at the trial or at the *de bene esse* depositions taken before the trial. We submit that such a failure to produce important witnesses gives rise to an unfavorable inference. See, for instance, *The New York,* 175 U. S. 187, 204 (1800); The *Georgetown,* 135 F. 854 (1905).

At the discovery depositions, Sha proved to be a most reluctant witness. Sha states at page 886:

> "Q. Captain, I show you your vessel's chart, marked Exhibit 5. Is your first anchored position off Astoria marked on this chart? A. I answered already those questions. No more questions.
>
> Q. Is your first position marked on the chart? A. No more answer for me today. You ask us before and this time too much nuisance.
>
> Q. Captain, referring to this chart, what is the circle— A. No, I'm sorry. I am leaving."

A vessel at anchor which has an opportunity to take action to avoid collision must do so. If a vessel sees approaching danger, and has it in her power to avoid or to mitigate the accident and she fails to do so, she is at fault. In *The Sapphire,* 11 Wallace, 164, 171 (1870), the Supreme Court criticized an anchored ship for failure to take seasonable efforts to avoid collision with a drifting vessel. In that case the watch officer aboard the anchored vessel failed to pay out anchor chain, or take other steps to avoid collision, until it was too late. Mr. Justice Bradley stated at page 171:

> "We cannot avoid the conviction that there was a want of proper care and negligence on the part of the officers of the *Euryale,* and that this contributed to produce the collision which ensued."

In the *West Cherow,* 276 Fed. 585, 589 (Eastern District of Virginia, 1921), an anchored vessel was held at fault

for failing to prepare her engines to maneuver out of the way, when it became apparent that another vessel was dragging towards her. The court stated at page 589:

> "There can be no excuse for the failure of the *West Cherow*, with a full head of steam on three boilers and everything in condition, to promptly direct the ship's movement."

The *Ogemow*, 32 Fed. 919, 925 (Eastern District of Wisconsin, 1887) involved a collision between an anchored barge and tow under way. The barge was held at fault for failing to slack out more chain, or port the helm. Judge Dyer states at page 925:

> "If her helm had been promptly put to port, and thus, by the force of the current, the stern of the vessel had been worked over to leeward and the bow turned off to starboard and if, in addition to this more anchor chain had been run out, thus allowing the vessel to drop down the stream with the current, and if all this had been done, as it might have been, before a collision was actually impending, it is highly probable the collision would have been avoided, or that the damages occasioned thereby would have been lessened."

See also: *The Averly*, 58 Fed. 794 (S. D. N. Y. 1893); *The Bacchus*, 267 Fed. 468 (E. D. Va. 1920); *The Irishman*, 259 Fed. 301 (E. D. Va. 1919); *The Baltimore*, 283 Fed. 728 (1st Cir. 1922); *Wells* v. *Armstrong*, 29 Fed. 246 (S. D. N. Y. 1886); *Villain E. Fassie E Compagnia* v. *Tank Steamer E. W. Sinclair;* 207 F. Supp. 700 (S. D. N. Y. 1962) at p. 713, *aff'd*, 313 F. 2d 722, *cert. denied*, 373 U. S. 948.

The errors with repect to the *Jane Stove*.

The *Jane Stove*, which we contend interfered with the navigation of the *Otello*, had been maneuvering through the crowded anchorage for several hours prior to the collision, and had unsuccessfully tried to anchor on three occasions that day (R. 284-290). Her third erstwhile anchorage position had been about one-third of a mile astern of the *Grand Grace* (B p. 33).

At about the same time that the *Otello* began dragging her anchor, the *Jane Stove* noted that her own anchor was not holding, and commenced heaving up, and maneuvering down stream in the direction of the *Otello* and *Grand Grace* (R. 290-291).

As the *Jane Stove* approached these vessels, her pilot and captain observed that the *Otello* was heading at a 90 degree angle to the other vessels in the anchorage and was in obvious difficulty (R. 310-311, R. 1401). Nevertheless, the *Jane Stove's* pilot headed her directly across the *Otello's* bow, rather than to the north where there was more than ample room (R. 293-294). The *Jane Stove's* deep draft was 18 feet 7 inches (R. 1429) so that she had more than 500 yards of free water sufficiently deep to accommodate that draft to the north of the channel, in addition to the channel itself. As discussed earlier, it was the close approach of the *Jane Stove* on this hazardous course that prevented the *Otello* from keeping her engines going ahead, so that she could maneuver into open water, and compelled her instead to reverse her engines. According to witnesses aboard the *Otello,* the *Jane Stove* passed only about 50 to 70 feet off the bow of the *Otello* (R. 427).

The Trial Court very apparently overlooked the deposition testimony of the Master and Watch Officer of the *Jane Stove.* The Master admits that as he approached the *Otello,* she appeared to be dragging her anchor but that nevertheless his vessel continued across the bow of the *Otello,* passing only about 100 yards off. The Master further testified that as his vessel passed the *Otello,* he noted that the *Otello's* propeller was not turning, and that if it had been turning, and the *Otello* had been moving forward to clear across the bow of the *Grand Grace,* there would have been a dangerous situation between the *Jane Stove* and the *Otello.* Thus, this very important witness for the *Jane Stove* admitted the fact that the *Otello* held up on account of the *Jane Stove* (which ultimately resulted in a collision with the *Grand Grace*) and so avoided danger for the *Jane Stove.* In other words, the *Jane Stove* put herself in a position of danger and so hin-

dered the *Otello* as to cause the latter's collision with the *Grand Grace.*

Captain Christoffersen, Master of the *Jane Stove*, testified on page 1401:

> "Q. Did it appear to you that the Swedish ship was drifting — A. Yes.
>
> Q. —or dragging her anchor? A. Yes."

* * * and on page 1403:

> "Q. Were you watching the propeller of the Swedish ship with your glasses? A. Well, I was looking to see if it had any movements.
>
> Q. Looking to see what? A. If it doing any movements with the propeller. But I'm quite sure I would have seen if it had start moving.
>
> Q. Why were you looking at the propeller to see if it was moving? A. Because if he had been moving we could get into a danger."

* * * and at page 1387:

> "Q. How close were you to the Swedish ship as you passed her, how close was your ship? A. At least a hundred meters.
>
> Q. And how close was the Swedish ship to the Chinese ship at that time? A. Well, that was very close to us when we passed it. It was not so far, any distance."

This *de bene esse* testimony of the *Jane Stove* master flatly contradicts the testimony of the *Jane Stove's* pilot in significant respects. The pilot on the *Jane Stove* testified that after he discovered he was dragging his anchor, he picked up the anchor and proceeded downriver toward the *Grand Grace, Otello* and *Antinous* at full speed but that his ship was on a course well clear of the *Otello* and *Grand Grace;* that he was navigating in the prescribed ship channel, along the Astoria Range, well to the north of the colliding ships and presented no danger to them (R. 293-4).

But the Captain of the *Jane Stove*, who was on the bridge throughout this period with the pilot, plotted the course that

his vessel followed, and this clearly shows that at no time did the *Jane Stove* navigate along the Astoria Range and that, in fact, she navigated well south of the Astoria Range outside the regular channel between the *Otello,* drifting toward the *Grand Grace,* and the *Antinous* which was admittedly anchored south of the channel (App. B p. 33).

The pilot of the *Jane Stove* testified, self protectingly, that when he got under way from his third anchored position, allegedly directly astern of the *Antinous,* he proceeded down the main ship channel, along the Astoria Range (R., Quinn, p. 131, 289).

The anchored position of the *Jane Stove,* as plotted by her Master, flatly contradicts this self-serving testimony (App. B p. 33). This plot indicates that the *Jane Stove* did not anchor in the main ship channel dead astern of the *Antinous.* Rather, she anchored south of the channel, with the *Antinous* on her starboard bow, and the *Grand Grace* on her port bow. The Master of the *Jane Stove* testified at p. 1392:

> "Q. Where was the *Grand Grace* in relation to your ship when you anchored the third time? A. I I think we had him a little bit on the port side.
>
> Q. A little bit on the port quarter? A. Port quarter, port bow.
>
> Q. A little bit on the port bow? A. When we anchored the third time.
>
> Q. Were you directly astern of the American cargo ship at that time? A. No. We had him a little bit on the starboard side, as far as I can remember."

The *Jane Stove's* watch officer on the bridge also testified that the American cargo ship (*Antinous*) was a little bit *on his vessel's starboard bow* as his vessel went down-river from her anchorage before the collision. R. pp. 1473-5.

> "Q. And at any time while you were proceeding down river did you notice those red lights? A. Yes, I did see the red lights.
>
> Q. And when you saw the red lights, was that before or after you passed the Swedish ship? A. I saw them both before and after.

Q. And when you saw them were they lined up so as to indicate that you were on the range? A. That I didn't notice.

Q. When you saw the red lights, the range lights, now, what was it that you saw? A. I saw two red lights.

Q. And what position were the two red lights in? A. I can't quite remember.

Q. Do you remember whether or not they were open?"

* * * * * *

"Q. Do you recall whether the range lights were closed or whether they were open when you saw them? A. When we anchored the last time they were open.

Q. You turned around and came down river, is that right? A. Yes.

Q. Now, as you turned around and came down river, just after you turned and were coming down river did you see the American ship? A. Yes.

Q. You have testified about passing an American ship. You testified that, as you passed the Swedish ship, there was an American ship on your starboard bow. Was that a tanker? A. No.

Q. The tanker was a different ship, is that right? A. Yes.

Q. Where was the tanker? A. It was further up the river.

Q. Did you pass the tanker? A. Yes. We went around it.

Q. And then after you came around the tanker, did you then proceed down river? A. Yes.

Q. And as you proceeded down river, just after turning and passing the tanker, did you see the American Ship? A. Yes.

Q. How was she bearing from you at that time? Was she dead ahead or off your starboard bow or off your port bow, or where? A. Slightly on the starboard bow."

The *de bene esse* testimony given by the *Jane Stove's* own master and watch officer is confirmed by the deposition testimony given by the American cargo ship *Antinous*. This testimony directly confirms the fact that the *Jane*

Stove proceeded between the drifting *Otello* and the *Antinous,* and that the *Jane Stove* did not direct her course clear of obvious danger.

The chief mate of the *Antinous* testified as follows at pages 1734, 1735:

> Q. One other thing I wanted to get before you left, you mentioned that the Swedish ship was in irons, that the Norwegian ship was down in the vicinity of these other two as the Swedish ship drifted toward the Liberty ship? A. In this general location here you are talking about (indicating)?
>
> Q. Well, at that time when you mentioned "in irons", did you mean that the Norwegian ship was to some extent interfering with the ability of the Swedish ship to get out into the channel? A. When they got in the vicinity of the Liberty ship then I would say this ship coming downriver was moving at the same time.
>
> Q. And so that the ship coming downriver, the Norwegian ship, was in the vicinity at the time that the Swedish ship was drifting down on the Liberty ship? A. That is right.

Chief Mate Boese states at pages 1709-1711:

> Q. I think the evidence will bear out. Where was this ship, the *Jane Stove,* when you first saw it? A. Well, she was——
>
> Q. Just in words now, and I will give you an opportunity to draw a— A. When I first noticed it coming downriver she was—can I see the chart again there.
>
> Q. Surely. A. I would say she was about abeam of this point, Tongue Point.
>
> Q. Just off Tongue Point? A. Just off Tongue Point, because I was looking there at the time I saw her.
>
> Q. In other words, she was upriver from you? A. She was upriver from us.
>
> Q. She was off your stern, in other words? A. That's right.
>
> Q. Do you know whether she was in the channel at that time? A. I do not know.
>
> Q. Did she proceed toward you? A. She proceeded toward us downstream.

Q. And as she did so did she maintain a steady course or did she appear to change course? A. She had a steady course at the times I was watching her.

Q. She did not appear to change or alter course? A. I didn't notice her alter course.

Q. As she approached you was she, would you say she was directly astern of you or was she to one side or the other? A. Well, I would say she was a little off of the port quarter. Looking from the bow.

Q. Little off the port quarter? A. Little off the port quarter.

Q. That is a little astern of you? A. Astern and off the——

Q. Port quarter? A. Yes. You could see it from the bow. I mean, if it had been directly behind the ship I couldn't have seen it from the bow there because of our ship.

Q. Did this ship, the *Jane Stove*, pass your port beam? A. She passed our port beam.

Q. She did? A. She passed inside.

Q. What was the distance between your ship and the *Jane Stove* when she passed your port beam? A. I don't recall the exact distance but a safe distance. I have no way of checking it.

Q. Do you recall where the Swedish ship was at the time the *Jane Stove* passed your beam? A. She was down by the—as far as I could see she was down close to the Liberty.

Q. She was close to the Liberty? A. I don't know whether she had already collided at the the time or not. I do not know, but she was close to the Liberty. She was drifting down on the Liberty. Exact time she collided and so forth I do not recall.

The *Jane Stove's* pilot was obviously attempting to place his vessel as far removed from the collision area as possible, to evade the charges that his reckless navigation interfered with the *Otello*, thereby bringing about the collision between the *Otello* and *Grand Grace*. However, the testimony of the *Jane Stove* Master and of her watch officer and of the master of the *Antinous* clearly refute her pilot's story.

It is significant that the officers of the *Grand Grace* acknowledged that the *Otello* would probably have avoided collision with the *Grand Grace,* but for the fact that *Otello* first stopped her engines and then went astern as she drifted toward the *Grand Grace* (which engine maneuvers by *Otello* were necessitated by the crowding of the *Jane Stove*). Hao Wang of the *Grand Grace* testifies at page 1167 of the record:

> "Q. He was coming down sort of sideways? A. Yes, gradually. I don't know why. Like this. Either go this way, this way or come this way. He come very close to us. The engines stopped. Engines not moved; I saw this is very dangerous.
>
> Q. When he was very close the engine was not moving? A. If the ship keep going maybe no trouble, maybe not hit our ship.
>
> Q. In other words, if the *Otello* had gone ahead as she drifted down you think she could have passed safely astern of the Waterman ship? A. Yes; he have plenty of room. If he keep going he pass astern the Waterman ship."

Captain Sha stated at page 837:

> "Q. What happened from that time on? Did she continue to move towards you? A. No. Actually, she is shifting anchorage, and if she is going to fairway she would have been all right, I should think. But afterwards she stopped on our bow, like this, in this position (indicating)."

* * * and at page 840:

> "Q. What did you think as she continued to remain in that same angle but came closer to you, broadside? A. Well, if she remains in this position?
>
> Q. Yes. A. If she remains in this position (indicating)——
>
> Q. That is No. 2 you are point to. A. We got trouble also, but she is moving in this position (indicating). She move quite fast, now slow.
>
> Q. In a cross-channel direction? A. Going this way, so if she keeps going like that, you see, that still can clear our ship.

> Q. You have just indicated a position 4 with red, that if she continued — A. If she continued that direction on the engines, she will be all clear of our ship."

The evidence clearly portrays careless handling by the *Jane Stove*. Thus, the *Jane Stove*, using too much headway and under very unfavorable weather conditions, undertook to navigate through an anchorage area dangerously close to three vessels, one of which, the *Otello*, was drifting down on another (*Grand Grace*), and the drifting *Otello* had another vessel (*Antinous*) relatively close ahead. But, unbelievably, the *Jane Stove* headed between *Otello* and *Antinous*—a needless and heedless maneuver. Their respective relative positions which were observed by the *Jane Stove* presented an extraordinary situation, calling for the exercise of the greatest caution by the *Stove*. Nevertheless, she "barged" ahead needlessly and unheeding on a course between the *Otello* and the *Antinous*. Her actions plainly produced a situation for the *Otello* which placed the *Otello* "in irons", so to speak, leaving her at the mercy of the wind and current, and prevented the *Otello* from taking the action which would have kept her clear of the *Grand Grace*.

It is, of course immaterial in assessing the liability of the *Jane Stove* that she was not in actual physical contact with either the *Otello* or the *Grand Grace*. Griffin on *Collision* states on page 504:

> "A vessel which crowds another into collision with a third vessel, or which, by faulty navigation, brings about such an accident between other vessels is liable, even though she herself does not come into collision."

In *Standard Oil Co.* v. *United States*, 82 F. Supp. 738 (S. D. N. Y. 1949), affirmed 174 F. 2d 182 (2nd Cir. 1949), the tanker *George W. Barnes* was traveling in a convoy on the port side of the SS. *George W. Lively*. This convoy was proceeding northbound. On the approach of a southbound convoy, the Commodore of the northbound convoy ordered his convoy to make an emergency 45 degree turn to

the right. The *Barnes* commenced execution of this course change, but the *Lively,* on her starboard side disobeyed the order and turned left towards the *Barnes.* The *Barnes* attempted to avoid collision with the *Lively,* and in so doing collided with the *Pan Virginia* in the southbound convoy. The court exonerated the *Barnes* and held the *Lively* and *Pan Virginia* liable for the collision.

In *The Susquehanna,* 134 Fed. 641, 646 (S. D. N. Y. 1905), the steamer *Susquehanna* was held at fault for crowding the steamer *Princeton* into a collision with a third vessel. The court stated at page 646:

> "These views lead to the conclusion that the *Susquehanna* brought the *Princeton* in peril of collision, and that to extricate herself the *Princeton* must back. If in going astern the *Princeton,* using such caution as the exigencies of the case and the excitement of the movement permitted, collided with another vessel, the *Susquehanna's* negligence would be the proximate cause. It would be like a person springing out of the way of a negligently driven wagon and striking another object (Coulter *v.* A. M. U. Express Co., 56 N. Y. 585), or a passenger jumping from a train, negligently brought into danger, (Dyer *v.* Erie R. Co., 71 N. Y. 228). Such cases are numerous."

Further, the *Jane Stove* was proceeding at an excessive speed through an anchorage area. *Griffin on Collision* commented on such practice as follows at page 350:

> "If the moving vessel passes over anchorage grounds, at least in the absence of some peculiar necessity, she takes the risk of doing so and must use extreme care though such navigation is not per se unlawful * * *."

So, the misconduct of the *Jane Stove* charges her with liability for the *Otello's* forced collision with the *Grand Grace.* In turn, the *Grand Grace* is in equal fault with the *Jane Stove* in that the *Grand Grace* failed to take any measures open to her which would have avoided the plainly threatened collision.

POINT III.

The trial court's erroneous determination of negligence is a conclusion of law reviewable on appeal.

This case involves the simple question of whether the facts demonstrate negligence on the part of any or all of the vessels named as parties. Determinations of negligence in admiralty are reviewable. This is so, since an appellate court cannot determine whether the correct standard of due care has been applied to the facts of the case where, as here, the standard is not discussed and the facts relative to the standard are not expressly resolved. In *Kane* v. *Branch Motor Express Co.*, 290 F. 2d 503, 506 (2d Cir. 1961), the Court said, at p. 506:

> "When a judge sitting without a jury passes on the issue of negligence, his conclusion is freely reviewable on appeal and is not to be tested by the 'clearly erroneous' standard of Rule 52(a), F. R. Civ. P., 28 U. S. C. A. Romero *v.* Garcia & Diaz Inc., 2 Cir., 1961, 286 F. 2d 347, 355, certiorari denied 81 S. Ct. 905, and authorities there cited. This is because a Court of Appeals cannot determine, when there has been no charge to the jury, whether the correct standard of due care has been applied to the facts of the case. This principle is, of course, equally applicable whether the trial judge finds negligence or whether he exonerates the defendant. In either case, the Court of Appeals must decide whether the finding can stand if tested by a properly formulated standard of care."

In *Romero* v. *Garcia & Diaz, Inc.*, 286 F. 2d 347, 355 (2nd Cir. 1961), *cert. denied*, 365 U. S. 869, Judge Friendly writing for a unaninous Second Circuit decision said at p. 355:

> "Many decisions in this circuit, some in civil actions and others in admiralty, have held that a judge's determination of negligence as distinguished from the evidentiary facts leading to it is a conclusion of law freely reviewable on appeal and not a finding of fact entitled to the benefit of the 'also clearly erroneous rule' (cases cited)."

POINT IV.

The court erred in allowing litigation expenses (specification of error 9 above).

In its final decree, the trial court made the following awards:

> "2. Grace Navigation Corporation shall have and recover from and against the M. V. *Otello* and Rederiaktiebolaget Soya and the guarantors on its letter of undertaking for release of the M. V. *Otello* the sum of Thirty Eight Thousand Dollars ($38,000.00)* plus $1,884.84 interest thereon to and including July 19, 1965, *plus $1,795.12 litigation expenses,* amounting to a total of $41,679.96, together with taxable costs in the amount of $112.50 with interest at 6 per cent per annum on said total sum from the date of this decree until paid.
>
> "3. Lorentzens Skibs A/S as owner of the *Jane Store* shall have and recover from and against the M. V. *Otello* and Rederiaktieholaget Soya and the guarantors on its letter of undertaking for release of the M. V. *Otello the sum of $2,409.89 expenses of litigation and* together with taxable costs in the amount of $, with interest thereon at 6 per cent per annum from date of this decree until paid."

We submit that allowance of these "litigation expenses" is unsupportable.

The so-called "litigation expenses" consist, among other things, of non-taxable long distance telephone expenses, surveys of damage to the *Grand Grace,* and witnesses' expenses (R. 112, 113, 120, 121). While the awarding of costs is within the discretion of the trial court, this discretion does not permit the award of non-statutory expenses and unrecognized disbursements. This circuit has consistently held that an appellate court, in passing on the merits of a case, may, upon proper assignment of error,

---

* Damages as stipulated by the parties.

correct a departure from settled principle in the disposition of costs. *The Lily,* 69 F. 2d 898 (9th Cir. 1934); *The Lurline,* 73 F. 2d 808 (9th Cir. 1935).

Conclusion.

We submit that the evidence and the applicable law in this case clearly indicate that the negligent actions of the *Jane Stove,* combined with the negligent inaction of the *Grand Grace* were the sole causes of the collision between the *Otello* and the *Grand Grace.* Furthermore, it is not negligence *per se* for a vessel such as the *Otello* to drag her anchor. The *Otello* acted reasonably under unexpectedly adverse conditions, and would never have come into collision with the *Grand Grace,* but for the combined negligence of the *Grand Grace* and *Jane Stove.*

The decree below should be reversed to adjudge respondent-appellees Grace Navigation Corporation and the SS. *Grand Grace,* and Lorentzens Skibs A/B and the M/V *Jane Stove* in fault and liability, with costs below and of this appeal, awarded to libelant-appellant Rederi A/B Soya.

Respectfully submitted,

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Kinsey & Williamson,
Kenneth E. Roberts

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Rederi A/B Soya.

Dated, March 31, 1966.

Certificate of Counsel.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

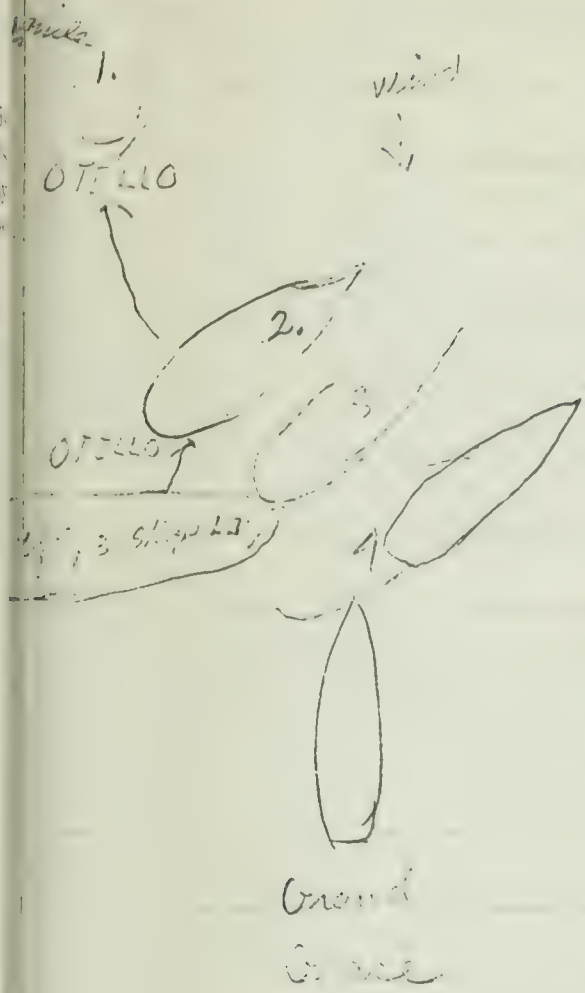
.....

David C. Wood

Appendix A.

Diagram

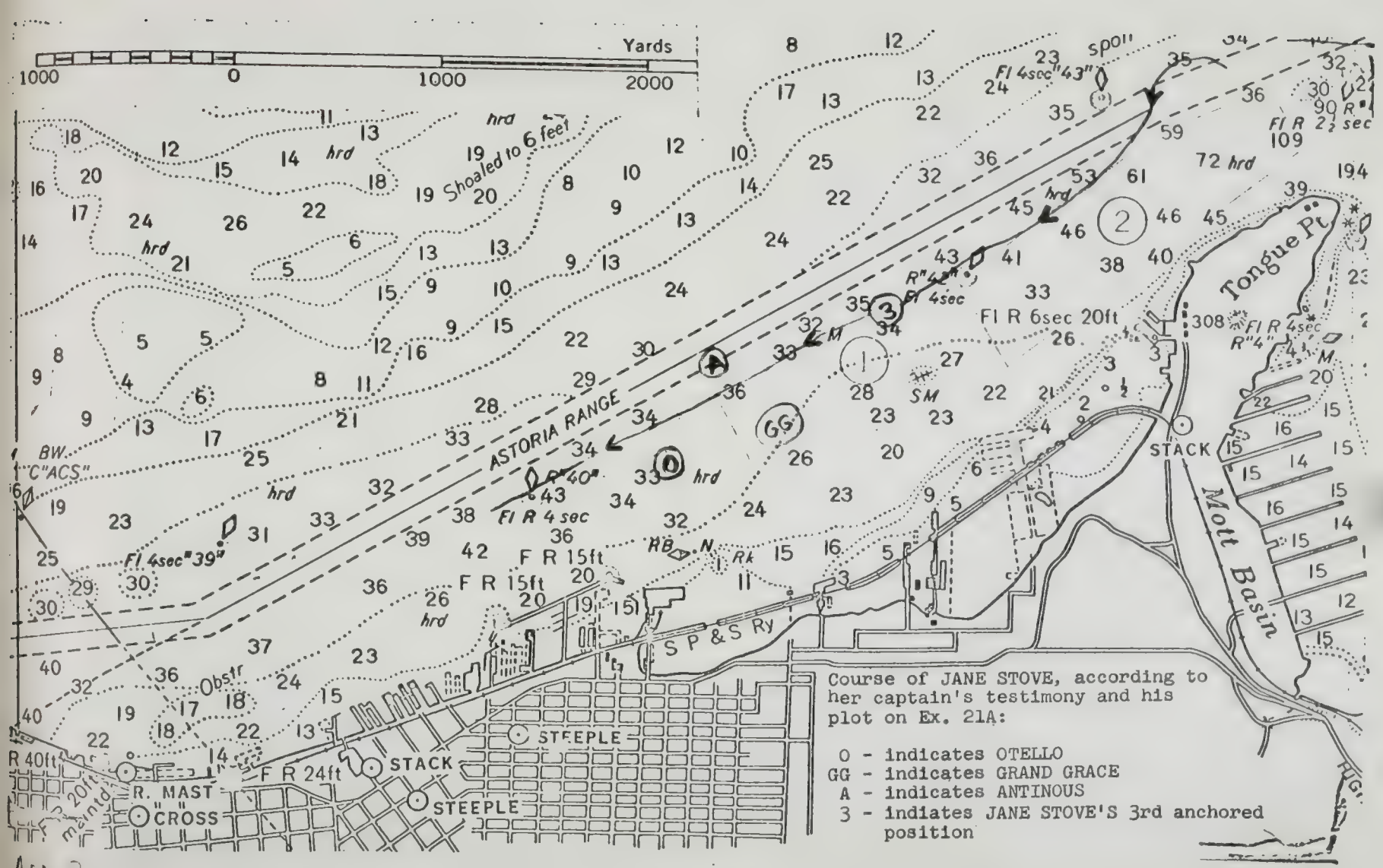
(Opposite ☞)


1.
OTELLO
2.
OTELLO

Appendix B.

Diagram

(Opposite ☞)


Yards
1000
0
1000
2000
Shoaled to 6 feet
ASTORIA RANGE
Fl 4sec "43"
Fl R 2½ sec
Fl R 6sec 20ft
Fl R 4sec
Fl 4sec "39"
F R 15ft
F R 24ft
R 40ft
S P & S Ry
STACK
STEEPLE
R. MAST
CROSS
Tongue Pt
Mott Basin
Obstr
BW
"C"ACS"
Course of JANE STOVE, according to her captain's testimony and his plot on Ex. 21A:
O - indicates OTELLO
GG - indicates GRAND GRACE
A - indicates ANTINOUS
3 - indiates JANE STOVE'S 3rd anchored position

App 3

No. 20591

United States
COURT OF APPEALS
for the Ninth Circuit

REDERI A/B SOYA, as owners of the Swedish Motor Vessel OTELLO,

Appellant,

v.

The SS. GRAND GRACE, her Engines, etc., and her Owners, GRACE NAVIGATION CORPORATION,

and

The MV JANE STOVE, her Engines, etc., and her Owners, LORENTZENS SKIBS A/S,

Appellees.

BRIEF OF THE "JANE STOVE" APPELLEE LORENTZENS SKIBS A/S

Upon Appeal from the United States District Court, for the District of Oregon

HONORABLE JOHN F. KILKENNY, District Judge

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No. 20591

United States
COURT OF APPEALS
for the Ninth Circuit

REDERI A/B SOYA, as owners of the Swedish Motor Vessel OTELLO,

Appellant,

v.

The SS. GRAND GRACE, her Engines, etc., and her Owners, GRACE NAVIGATION CORPORATION,

and

The MV JANE STOVE, her Engines, etc., and her Owners, LORENTZENS SKIBS A/S,

Appellees.

BRIEF OF THE "JANE STOVE" APPELLEE LORENTZENS SKIBS A/S

Upon Appeal from the United States District Court, for the District of Oregon

HONORABLE JOHN F. KILKENNY, District Judge

STATEMENT

Appellant's "Statement" should more appropprately have been included in the "Argument" section of appellant's brief. It consists, for the most part, of a recita-

tion of appellant's contentions—contentions which have been controverted throughout by both appellees and which were expressly rejected by the trial court as being based on "shadowy, illusory and in most instances non-existent" evidence (Mem. Dec., R. 74).

At the outset, the relative positions of the involved vessels prior to the collision is not correctly stated in appellant's brief. The location of the ANTINOUS is obviously most accurately fixed by reference to her own anchor bearings. According to these, she was anchored in the main ship channel, right on or a little bit north of the center line of the Astoria Range (R. 1616, 1629, 1632, 1704). This conforms closely with the testimony of Pilot Quinn, who also placed the ANTINOUS slightly north of the Astoria Range (R. 289, Ex. 22A, 22B).

Contrary to appellant's statement that the OTELLO was anchored only 500 feet from the ANTINOUS, the most reliable evidence (the ANTINOUS' radar) established that the two vessels at no time were ever closer to each other than .2 of a nautical mile, or approximately 1200 feet (R. 1613, 1640, 1670). It is thus seen that the OTELLO had much more room in which to maneuver than appellant's brief would indicate.

Appellant correctly states that at about 2:30 p.m., the OTELLO commenced dragging anchor and that, some time later (established by the OTELLO's Chief Mate and carpenter to be well after 3:00 p.m.—R. 414, 584), the order was given to heave in the anchor. There is no dispute that the OTELLO's anchor chain caught across her bow and the bow then swung to the right,

leaving her broadside to the wind and heading in a generally northerly direction. From this point, however, appellant's elaborate explanation of the OTELLO's efforts to regain control of her movements, and why they were unsuccessful, is completely at odds with the credible evidence presented.

That the OTELLO did continue to drag and ultimately was set down onto the GRAND GRACE is established. The rest of appellant's "facts"—and specifically that portion which characterizes the actions of the JANE STOVE as negligent—is pure argument and will be treated later in this brief.

ARGUMENT

Summary

The trial court's specific findings that the JANE STOVE was not at fault and that the collision was caused solely by the "flagrant and major" fault of the OTELLO are supported by substantial evidence and are not clearly erroneous, and should therefore not be set aside.

The trial judge did make independent findings of fact, as reflected in his Memorandum Decision (R. 74). The fact that the formal findings of fact thereafter entered were prepared with the assistance of counsel does not make them any the less findings of the court.

Affirmative findings of negligence and the absence thereof are findings of fact within the "clearly erroneous" rule and are not mere conclusions of law.

I

The "Clearly Erroneous" Rule Applies.

McAllister v. *United States* (1954) 348 U.S. 19, 75 S. Ct. 6, 99 L. Ed. 20,

established that federal appellate courts have no greater scope of review in admiralty than under Rule 52(a) of the Federal Rules of Civil Procedure and that the findings of fact of a trial court sitting in admiralty may not be set aside unless they are clearly erroneous.

Since that decision, this court has consistently followed the rule.

> Gypsum Carrier, Inc. v. Handelsman (C.A. 9, 1962) 307 F.2d 525;
>
> Albina Engine & Mach. Wks. v. American Mail Line, Ltd. (C.A. 9, 1959) 263 F.2d 311.

II

The Findings Below Are the Court's Findings and Are Findings of Fact, Not Merely Conclusions.

Apparently recognizing the difficulties confronting any argument that the findings of the trial court in this case are clearly erroneous, appellant seeks to obtain a de novo review of the evidence by contending that the findings below are really not those of the trial judge and that, in any event, they are not findings of fact at all but merely conclusions (App. Br., Point I, pp. 8-10 and Point III, p. 27).

Appellant's charge that the trial judge did not exercise his "independent and unfettered judgment" is patently spurious and is an altogether unwarranted attack

upon the integrity of the trial judge. After the case was fully submitted and exhaustively briefed, the district court handed down its Memorandum Decision (R. 73-74), which detailed the specific charges of negligence found against the OTELLO and announced the court's finding that no fault had been established against the GRAND GRACE or the JANE STOVE. Thereafter, at the trial court's request, these holdings were incorporated into formal findings of fact by counsel and, upon submission to the court, were adopted in such form as the court's findings of fact.

Under these circumstances, it is clear that the findings entered were, in fact as well as in form, those of the court. Of great significance in demonstrating that the trial judge did exercise his independent judgment is the fact that several of the charges of negligence which the GRAND GRACE asserted against the OTELLO were rejected in the trial court's Memorandum Decision.

That the formal findings were prepared by counsel and thereafter adopted by the court in no way detracts from their force.

Molitor v. *American President Lines, Ltd.*
(C.A. 9, 1965) 343 F.2d 217, 219.

This court there commented:

> "It is immaterial that counsel for the prevailing party, at the request of the court, prepared the findings.
>
> "The only question concerning the facts of this case which this court may appropriately consider is whether any of the essential findings of fact are

clearly erroneous. McAllister v. United States, 348 U.S. 19, 20, 75 S. Ct. 6, 99 L. Ed. 20."

In the case of

Mississippi Valley Barge Line Co. v. *Cooper Terminal Co.* (C.A. 7, 1954) 217 F.2d 321, 332-323

the court held that the "clearly erroneous" rule applied whether the court prepared its own findings or adopted those submitted by counsel. The following language from that decision is most apposite to the instant case:

> "The transcrpt of the evidence in this case shows that the trial judge took an active part in questioning witnesses when a fact in issue was not being properly brought out. It is perfectly clear to us from reading this record that the court was keenly aware of all the contentions made, and did come to its own definite conclusions at the end of the testimony. It was perfectly proper to ask counsel for the successful party to perform the task of drafting the findings and conclusions. If they had not reflected the court's own ideas as to what the findings should be they, of course, would not have been adopted."

As to appellant's argument that the findings of the trial court on the issues of negligence are reviewable de novo, suffice it to say that this is contrary to the established rule of this court.

Molitor v. *American President Lines, Ltd.* (C.A. 9, 1965) 343 F.2d 217, 219.

This court there stated:

> "* * * we hold that the implied finding of the

district court that there was no negligence or unseaworthiness in this regard is not clearly erroneous."

In the case of

Gypsum Carrier, Inc. v. *Handelsman*
(C.A. 9, 1962) 307 F.2d 525, 528

the district court had found that the libelant was not contributorily negligent. On appeal, this court rejected appellant's argument that this was a conclusion reviewable free from the "clearly erroneous" rule, commenting:

> "Thus we need not consider whether a trial court's conclusion as to the existence of negligence is generally to be classified as one of fact or of law. Clearly enough in the present case it reflected a factual determination from conflicting evidence. There is nothing to indicate, as appellant suggests, that the District Court tested appellee's conduct against an improper standard of care.
>
> If the District Court had agreed with the appellant's resolution of the problems of proof, it also would have concluded that appellee was guilty of contributory negligence. The District Court did not interpret the evidence as appellant does, and neither do we. On an examination of the whole record, we cannot say that the District Court's determination that appellant failed to carry its burden of proving contributory negligence was clearly erroneous."

Pacific Tow Boat Co. v. *States Marine Corp. of Delaware* (C.A. 9, 1960) 276 F.2d 745, 752.

There the appellant contended, as does appellant here, that a determination that a party is or is not negligent is a conclusion of law and is therefore not protected by the "clearly erroneous" rule announced in

McAllister. This court rejected the appellant's contention, stating:

> "In the McAllister case the Supreme Court dealt specifically with a 'finding of fact' that the master of the ship was negligent. It was with respect to this finding that the court there held that 'no greater scope of review is exercised by the appellate tribunals in admiralty cases than they exercise under Rule 52(a) of the Federal Rules of Civil Procedure.' *Since that decision this court has uniformly regarded determinations as to negligence made in admiralty cases as findings of fact which are not to be overturned unless clearly erroneous.*" (Emphasis supplied.)

Accord:

Albina Engine & Mach. Wks. v. American Mail Line, Ltd. (C.A. 9, 1959) 263 F.2d 311.
United States v. Harrison (C.A. 9, 1957) 245 F.2d 911.
United States v. The Agioi Victores (C.A. 9, 1955) 227 F.2d 571.

III

The Finding of No Fault on the Part of the JANE STOVE Is Supported by Substantial Evidence

The essence of appellant's charge against the JANE STOVE is that she proceeded recklessly through the anchorage area and directly across the OTELLO's bow, thereby preventing the latter from navigating ahead into the channel and forcing her to continue her drift on into collision with the GRAND GRACE. To establish this charge it was incumbent upon appellant to prove the following:

a. That the JANE STOVE was, in fact, proceeding in the anchorage area;

b. That the OTELLO actually entertained the intention to navigate north into the main ship channel;

c. That the JANE STOVE should reasonably have recognized and appreciated the OTELLO's plight and divined her intention to proceed north into the channel;

d. That the JANE STOVE'S course took her sufficiently close to the OTELLO to critically impede the latter's navigation; and

e. That had it not been for the movements of the JANE STOVE the OTELLO would have been able to extricate herself from her predicament.

An objective review of the record will demonstrate that *none* of the foregoing elements of appellant's claim against the JANE STOVE were established by satisfactory evidence. On the contrary, not only is there some substantial evidence to support the trial court's finding that the JANE STOVE was free from fault, but the great weight of the credible evidence requires such finding.

The testimony of Pilot Quinn, who was at the conn of the JANE STOVE, is sufficient alone to exonerate the JANE STOVE from fault. As a Columbia River Bar Pilot of many years experience, he was the one navigator involved in this matter who was intimately familiar with the waters in question. Moreover, his testimony was given personally in court at trial and the trial judge was able to observe his attitude and demeanor while testifying.

Captain Quinn's testimony establishes that the JANE STOVE, after her attempt to anchor near the Coast Guard Station proved unsuccessful, proceeded upstream toward Tongue Point and there turned in the vicinity of Buoy No. 43 and headed down the main ship channel on the Astoria Range (R. 287-288). After attempting to anchor in the channel directly behind the ANTINOUS (R. 289), and when her anchor again failed to hold, the JANE STOVE heaved in her anchor and resumed her course down the channel on the Astoria Range (R. 290).

As the JANE STOVE so proceeded, Captain Quinn had the ship under complete control and had the other three vessels in the vicinity — the ANTINOUS, the OTELLO and the GRAND GRACE—under observation (R. 291). There was nothing to indicate to Captain Quinn that the OTELLO was having a problem that required any action on the part of the JANE STOVE. Although Captain Quinn did observe that the OTELLO was laying across the wind (R. 292), his observation of her disclosed simply a vessel at anchor in the anchorage, with nothing to indicate that she was maneuvering or that she entertained any intention of proceeding on a course which might conflict with that of the JANE STOVE (R. 292). Because of the position of the OTELLO, Captain Quinn did elect to pass the ANTINOUS on the leeward side as closely as possible, which he did (R. 293). As the JANE STOVE approached the ANTINOUS Captain Quinn heard no whistles froom the OTELLO (R. 295) or observed any other signal or indication from her that she wished the JANE STOVE to stop (R. 296) and, when the JANE STOVE passed by the OTELLO

there was still no indication of immediate danger of collision between the OTELLO and the GRAND GRACE. In any event, the JANE STOVE passed the OTELLO at a distance of 900 feet (R. 300) and accordingly was never sufficiently close to impede the OTELLO's navigation as appellant claims.

Captain Quinn testified that, under the circumstances presented, his most prudent course was to pass the ANTINOUS on the leeward side as closely as possible. He explained that although it would have been possible for him to have stopped the JANE STOVE in the channel or to have passed the ANTINOUS on the north, if necessary, these movements would have been hazardous because stopping would very probably have resulted in losing headway and control of his ship (R. 297) and passing to the north would have required him to leave the channel and go into an area where uncharted shoals frequently exist (R. 298, 314-316). These alternatives are entirely hypothetical, however, as, for the reasons set out above, there was nothing which reasonably indicated to Captain Quinn that such movements were necessary.

Captain Quinn's testimony that the JANE STOVE was in the channel and on the Astoria Range is supported by Captain Pullen, Master of the ANTINOUS (R. 1629) and by Ralph Regh, Second Mate of the TEXICO CALIFORNIA, another disinterested witness (R. 1919). Even the testimony of Captain Sundlof, the OTELLO's Master, indicates that the JANE STOVE was in the channel as she came downstream toward the ANTINOUS.

"Q. How did the JANE STOVE appear to be heading with relation to your vessel at that time?

A. When I first saw her a mile away, or something like that, then she seemed to me to be heading against the ANTINOUS.

Q. Did she ever seem to change that heading?

A. No.

Q. What do you mean when you say heading against the ANTINOUS?

A. Well, the ANTINOUS was—it was almost the same course or the same line as the ANTINOUS." (R. 182).

In view of the fixed position of the ANTINOUS at or a little bit north of the Astoria Range Line in the channel, the foregoing observation of Captain Sundlof necessarily puts the JANE STOVE in the channel.

Appellant endeavors to make much of the fact that the JANE STOVE'S Master, in his deposition, placed the JANE STOVE'S course somewhat to the south of the channel. This is not a significant discrepancy and, at most, simply posed for the trial judge the question of whether the Master or pilot was the more likely to be accurate. In view of Captain Quinn's intimate familiarity with these waters and the navigational aids there situated, as opposed to the Master's admitted uncertainty as to whether the ship was or was not in the channel, this was not a difficult question to resolve. Certainly, any such differences in observations do not "refute" or in any way discredit Captain Quinn's testimony, or justify the charge made by appellant that the trial judge violated his duty by failing to read depositions or, if he read them, that he ignored them.

Appellant has constructed an elaborate explanation of events tending to create the impression that the OTELLO, through no fault of her own, became trapped in a position of peril and that the only avenue to safety was for her to proceed north into the ship channel. However, an observation of the most credible evidence—that which is undisputed and that which comes from disinterested witnesses—casts serious doubt upon this version of the events. To begin with, it is apparent that the OTELLO actually made no effort to maneuver, at least until the collision with the GRAND GRACE was immediately imminent. Captain Pullen of the ANTINOUS, who perhaps had the best vantage point of all from which to observe events, stated categorically that from the time the OTELLO commenced dragging anchor she made no observable attempts to maneuver:

> "A. Well, looked like to me she was just paralyzed, or whatever it was, because she just kept drifting, drifting down. I know what I would have done if I was in her place, but I wasn't there so I will not say. . . . Well, I just saw her drifting down broadside and she was not able to heave in her port anchor and she didn't drop the starboard one, and she was just drifting down like a piece of wood. That is the only thing I can describe." (R. 1620)
>
> . . . . .
>
> "A. Well, *this one wasn't even navigating*, she was just drifting like a log, she was drifting from that time right down until she hit the GRAND GRACE in one straight line. She didn't drift this way, *she didn't do any maneuvering at all*, she just drifted, period." (Emphasis supplied) (R. 1693).
>
> . . . . .

"A. What is she doing about it, that is my answer. There she is drifting down like a piece of log. What has she done?" (R. 1695).

Chief Mate Boese of the ANTINOUS gave similar testimony:

"Q. And as you observed her did it appear that the Swedish ship was making any effort to get underway or to alter the drifting that she was making down toward the Chinese ship?

A. I didn't notice. She seemed like she drifted in a straight line to me.

Q. I take it then your answer is, as far as you could tell it did not appear that she made any effort to get underway or to do anything else to—

A. Or drop another anchor or anything.

Q. She did not?

A. She did not." (R. 1714, 1715).

It will also be remembered that all during this time the OTELLO still had her port anchor out, which throws additional doubt on her claimed intention to navigate out into the channel. Moreover, the OTELLO's bell book (Ex. 10B) contains no entries which reflect any such intended maneuver. This question is quite pertinent—if the intention to head out of the anchorage into the channel in fact existed, why were such maneuvers not undertaken much earlier? The OTELLO, equipped with twin diesel engines, was a highly maneuverable ship. Nothing in the record explains why she did not attempt to maneuver to the west or to the south, either of which directions presented clear water. Or if the movement to the north into the ship channel was considered the most desirable maneuver, it certainly could and would have been

made earlier. The JANE STOVE was not yet in the vicinity and the ANTINOUS, which was at least two-tenths of a mile away, could have been easily avoided. All these factors strongly suggest that the claimed intention to navigate northerly into the channel was conceived at much too late a time ever to have been acted upon under any circumstances.

Additionally, the record is entirely devoid of evidence which would in any way establish that those aboard the JANE STOVE were aware or should have been aware of this undisclosed intention of Captain Sundlof to move his anchored vessel into the channel.

Appellant makes much of the whistle signals which Captain Sundlof states were given by the OTELLO prior to the collision. It appears from the testimony of some disinterested witness that some whistle signals did emanate from the OTELLO prior to the collision. However, there is a hopeless conflict in the testimony as to whether these whistles were pilot signals, warning signals, when such whistles commenced to be blown, how frequently they were blown, for what purpose they were blown and when they ceased. Under any theory of the evidence, any such whistles were ambiguous and, even if heard, were inadequate to convey the information which the OTELLO now contends was or should have been conveyed thereby. In fact, even Captain Sundlof was unable to say with any certainty what he expected the JANE STOVE to do upon hearing his whistle signals, other than that he expected the JANE STOVE to give him "permission" to cross in front of the JANE STOVE (R. 228).

Many of the disinterested witnesses in the area, some of whom were closer to the OTELLO than the JANE STOVE, heard no whistle signals whatever. Captain Quinn testified that he heard no whistle signals from the OTELLO. In this, he was supported by the other personnel aboard the JANE STOVE. Upon this state of the record, appellant can claim nothing by reason of the testimony of the OTELLO personnel regarding the giving of whistle signals.

There is no other evidence in the record which would have placed a reasonably prudent navigator in Captain Quinn's position upon notice that any unusual action on his part was required. Insofar as Captain Quinn was aware, he was maneuvering his vessel properly down the channel, had the anchored vessels under close observation and saw nothing which would reasonably apprise him that the OTELLO had gotten herself so entrapped that her captain had concluded that the only avenue of escape was to proceed northerly into the path of the JANE STOVE. There is nowhere any evidence that Captain Quinn had reason to know that the OTELLO intended to get underway and head north. Based upon the facts available to him, Captain Quinn made a judgment decision, which was that the safest course for his vessel and the other vessels around him was to proceed as closely as possible past the ANTINOUS on the latter's leeward side and thus remove his vessel from the area. Captain Quinn obviously was not chargeable with knowledge at the time that the OTELLO would not drop her other anchor and thus stop her drift,

or that she would not maneuver to the west or to the south, or of Captain Sundlof's undisclosed decision, if it existed, to move his vessel in a northerly direction into the channel. In fact, it is extremely significant here that there is no testimony from any of the OTELLO personnel, including Captain Sundlof, to the effect that the OTELLO could *not* have been maneuvered to the west or to the south.

Captain Quinn's experience and qualifications as a mariner are of the highest caliber, he is thoroughly familiar with the waters in question, and his conduct must be judged, not by the hindsight of ingenious proctors, but in the light of the circumstances as they existed at the time. The trial court correctly found that, under these circumstances, Captain Quinn's judgment decision was not one which can be said to have created an undue risk of danger to the other involved vessel or one which would not have been made by a reasonably prudent navigator.

Moreover, regardless of the determination which is made concerning the propriety of Captain Quinn's judgment decision in connection with his maneuvering of the JANE STOVE, the credible evidence fails altogether to support the appellant's contention that any action of the JANE STOVE effectively prevented the OTELLO from maneuvering away from collision with the GRAND GRACE. Admittedly, the testimony of how close the OTELLO and the JANE STOVE came to each other varies from about twenty-five yards to approximately four hundred yards. Perhaps the most credible testimony on

this point is that of the disinterested Captain Pullen of the ANTINOUS, who was not only the closest uninvolved witness, but who also observed the ships on his radar. He placed the OTELLO and the JANE STOVE about two hundred, possibly three hundred, yards apart (R. 1615, 1616). Additionally, Captain Pullen stated that the JANE STOVE passed within seventy-five yards of the ANTINOUS (R. 1615, 1682). Captain Sundlof's testimony confirms this (R. 43). Captain Pullen put the radar distance between the ANTINOUS and the OTELLO at not less than two-tenths of a mile, or four hundred yards. Based upon these observations, the distance between the JANE STOVE and the OTELLO was something in excess of three hundred yards, or nine hundred feet.

Accordingly, it is seen that another essential part of appellant's case against the JANE STOVE—that the JANE STOVE passed so closely as to force the OTELLO to stop her forward maneuvers—has not been made out. In any event, the evidence at this point is more than sufficient to support the trial court's finding.

Inasmuch as appellee Lorentzens Skibs A/S is not directly concerned with the charges of negligence against the OTELLO, no review of the evidence in this particular regard will be undertaken in this brief. However, appellee Lorentzens Skibs A/S does express its concurrence with the position of co-appellee, Grace Navigation Corporation, which undoubtedly will present in its brief a detailed discussion of the OTELLO's fault. It is sufficient for appellee Lorentzens Skibs A/S to state that

the evidence below amply supports the trial court's finding No. 22:

> "The faults and negligence of the MS OTELLO and those in charge of her navigation were flagrant and major in character and were the proximate cause of and fully account for the collision, and if there were any doubts as to the conduct of the respondents or either of them, such doubts would be resolved in their favor." (R. 80).

IV

Litigation Expenses

The trial court, exercising its proper discretion, allowed this appellee's claim for litigation expenses in the amount of $2,409.89. Such expenses were, in the main, incurred in connection with pretrial depositions. The court's action in allowing this claim is authorized by *Vaughan* v. *Atkinson* (1962) 369 U.S. 527, 82 S. Ct. 997, 8 L. Ed. 88.

CONCLUSION

The trial court found, and stated in the clearest of terms, that appellant's suit below was meritless. The record fully supports the trial court's determination and, for the reasons set forth hereinabove, the decree of the district court in favor of the JANE STOVE and her owners should be affirmed, with damages for delay, pursuant to Rule 24 of this court.

Respectfully submitted,

KING, MILLER, ANDERSON,
NASH & YERKE
CURTIS W. CUTSFORTH
Proctors for Appellees
MV JANE STOVE and
Lorentzens Skibs A/S

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

CURTIS W. CUTSFORTH
Of Proctors for Appellees

No. 20591

United States
COURT OF APPEALS
for the Ninth Circuit

REDERI A/B SOYA, as owners of the Swedish Motor Vessel OTELLO,

Appellant,

v.

The SS. GRAND GRACE, her Engines, etc., and her Owners, GRACE NAVIGATION CORPORATION,

and

The MV JANE STOVE, her Engines, etc., and her Owners, LORENTZENS SKIBS A/B,

Appellees.

BRIEF OF "GRAND GRACE" APPELLEE GRACE NAVIGATION CORPORATION

Upon Appeal from the United States District Court, for the District of Oregon

HONORABLE JOHN F. KILKENNY, District Judge

WOOD, WOOD, TATUM, MOSSER & BROOKE,
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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 5-66

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REDERI A/B SOYA, as owners of the Swedish Motor Vessel OTELLO,

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The SS. GRAND GRACE, her Engines, etc., and her Owners, GRACE NAVIGATION CORPORATION,

and

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Appellees.

BRIEF OF "GRAND GRACE" APPELLEE GRACE NAVIGATION CORPORATION

Upon Appeal from the United States District Court, for the District of Oregon

HONORABLE JOHN F. KILKENNY, District Judge

STATEMENT OF FACTS

Appellant's so-called "Statement of Facts" is inaccurate, misleading, and ignores facts which resulted in the trial court finding OTELLO solely at fault for the collision.

Appellant tries to create the impression that OTELLO was "boxed in," and restricted in her navigation, by the closeness of the other vessels. Appellant states (Br. p. 2) that the ANTINOUS was anchored only 500 feet from OTELLO, and south of the main ship channel, and shows ANTINOUS in this position on the chart opposite page 2.

But Captain Pullen and Chief Mate Boese of the ANTINOUS located their vessel, based upon accurate bearings, in the middle of the main ship channel, right on the center line of the Astoria Range, (R. 1629, 1632, 1654, 1657, 1660, 1667) and at no time any closer than 2/10 of a nautical mile (1200 feet) from the OTELLO (R. 1613, 1640, 1670).[1]

Likewise appellant states (Br. p. 2) that GRAND GRACE was anchored ¼ to ½ mile astern of OTELLO. The accurate anchor bearings taken on GRAND GRACE show her position was 0.6 miles upriver (easterly) from OTELLO (Ex. 110, R. 1302-09). And appellant has placed GRAND GRACE, on the chart opposite Br. p. 2, at least 1200 yards, or 3600 feet (0.6 miles), distant from OTELLO.

In an effort to excuse OTELLO's dragging her anchor and her clumsy navigation, appellant greatly exaggerates the wind conditions. Admitting that winds of 35-50 knots had been predicted, appellant states (Br. p. 2) that the wind reached force 10-12 on the Beaufort

---

[1] OTELLO's master admits ANTINOUS was anchored 1200 feet distant from his vessel (R. 239). Pilot Quinn located ANTINOUS slightly north of the Astoria Range Line. (Exs. 22A, 22B)

Scale (65 knots). This was a self-serving *estimate* recorded in OTELLO's log. The actual measured wind velocity, from official records (Exs. 42, 118) of the United States Weather Bureau Station at the nearby Astoria Airport (more exposed to the wind than the partly sheltered anchorage area) was as follows:

Time	*Direction*	*Speed (in Knots)*	
1158	220	20	G40
1256	230	22	G35
1357	220	28	G45
1458	270	30	G55
1556	260	35	G50

Thus, from noon until 4 P.M. the winds were only 20 to 35 miles per hour, with occasional gusts up to 35 to 55 miles per hour. Neither OTELLO nor JANE STOVE made any defense of vis major in the pretrial order, or at any time before the trial court.[2]

Appellant states (Br. p. 3) that OTELLO's master noticed she was dragging anchor at 2:30 P.M., and "shortly thereafter" put her engines on "standby." Actually, the engines were not put on standby until 12 minutes later, at 2:42 P.M., and were not used until 24 minutes later, at 2:54 P.M. (Ex. 10B, R. 210-11), and OTELLO's master did not send anyone forward to her bow, to tend her anchors until about 3 P.M., a delay of 25 to 30 minutes after it was known she was dragging anchor (R. 414, 584-85).

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[2] The parties agreed in the pretrial order and the court found that there was a "strong westerly wind." (Agreed Facts 11, R. 51; Finding 11, R. 77)

Also, appellant states (Br. p. 3) after OTELLO heaved in about two shackles of chain (180 feet), the chain caught across her bow, "thus preventing the crew from heaving in any more chain." This happens often and is easily remedied (R. 460). And shortly afterwards OTELLO's bow swung to starboard and the chain was free (R. 205). Yet her master never made any attempt either to take in the anchor, or to let out more chain, but instead attempted to navigate encumbered by his chain and anchor and three shots of chain (R. 206-07).

Appellant states that "efforts to head OTELLO into the wind by use of her engines and helm were futile" (Br. p. 3). The fact is that OTELLO, although a twin screw vessel and thus highly maneuverable by use of her engines, never ran her starboard engine at full ahead until 1520, when collision was imminent (Ex. 10B).

The trial judge, having heard the master of OTELLO testify in person, found that OTELLO was negligent in numerous particulars, and that her faults "were major in character, were the proximate cause of and fully account for the collision " (R. 74, 80).

OTELLO's brief states that the GRAND GRACE "had observed the predicament of the OTELLO from the beginning (nearly an hour before), but made no effort whatsoever to avoid the collision." (Br., p. 4). This ignores the fact that both the master of OTELLO, and the officers aboard GRAND GRACE, testified that OTELLO was navigating out towards the channel and there was no reason for GRAND GRACE, lying properly at anchor out of the channel, to apprehend danger of

OTELLO colliding with her until a few moments before the collision, and then there was no time for GRAND GRACE to do anything to avoid collision (See infra, pp. 31-34). The master of every vessel on the scene testified there was nothing GRAND GRACE could have done to avoid the collision (See infra, pp. 29-31). The trial court found that GRAND GRACE was "not negligent or at fault in any of the respects charged by libelant, or otherwise" (Finding 18, R. 79). The court also found the collision "was not proximately caused by failure of the SS GRAND GRACE to let out anchor chain or to use its engines and rudder in the manner that libelant contends GRAND GRACE should have done" (Finding 19, R. 79).

We add a few additional facts:

GRAND GRACE was a Liberty-type ship. She was at anchor in the position marked on the chart opposite p. 2 of appellant's brief. She was in a designated anchorage area, well out of the ship channel, and had been there for two days (Agreed Fact 9, R. 51).

There was broad daylight and good visibility at all times involved.

OTELLO was a twin-screw vessel with 6,400 horsepower diesel engines (R. 51). At all times she had full use of her engines and rudder (R. 248). Having commenced to drag at 2:30 P. M., she commenced to heave in her anchor a little after 3:00 P. M. After swinging to a northerly heading, OTELLO attempted to pass by the ANTINOUS and proceed to the main channel or fairway (R. 388).

ARGUMENT

Summary of Argument

This appeal involves only questions of fact. The trial court found the OTELLO negligent in numerous particulars, and that her faults "were flagrant and major in character and were the proximate cause of and fully account for the collision" (R. 74, 80).

The court found that GRAND GRACE was not negligent, and that the collision was not proximately caused by any failure of GRAND GRACE to take avoiding action as contended by OTELLO (R. 79).

These findings of fact should not be set aside unless "clearly erroneous." *McAllister* v. *United States,* 348 U.S. 19 (1954). The findings are supported by abundant evidence, and also by the presumption that when a moving vessel strikes a vessel at anchor, the moving vessel is presumed at fault, and the anchored vessel is presumed to be innocent.

The trial court found libelant's contentions and supporting arguments resourceful, "but the evidence on which they are based is shadowy, illusory and in most instances non-existent." (Mem. Dec., R. 74; Finding 21, R. 79). This appeal, having been taken solely on questions of fact, and in the face of the rule of *McAllister* v. *United States,* appears to have been sued out primarily for delay, and appellee Grace Navigation Corporation requests damages for delay pursuant to Rule 24 of this Court.

I

The Trial Court's Findings May Not be Set Aside Unless Clearly Erroneous

By the well-known rule of *McAllister* v. *United States*, 348 U.S. 19 (1954) the trial court's findings of fact are binding and may not be set aside unless "clearly erroneous."

In *Albina Eng. & Mach. Wks.* v. *Amer. Mail Line, Ltd.*, 263 F.2d 311 (C.A. 9, 1959), this Court said:

> "The finding (that American Mail Line was not negligent) was not clearly erroneous. And by McAllister v. United States, the idea was laid to rest that this court can try admiralty fact questions anew." 263 F.2d 311, 314.

Faced with the "clearly erroneous" rule, appellant takes the desperate course of attempting to discredit the findings by wholly unwarranted charges that "impugn the integrity of the District Court." *Atwood* v. *Humble Oil & Refining Co.*, 338 F.2d 502, 512.

1. Charge of "Parroting."

Appellant charges that the trial court "parroted" or "rubber-stamped" the findings prepared by prevailing counsel (Br., pp. 6-8). The fact is that two months after the trial was concluded (R. 323) and after appellant's counsel had filed three briefs totalling 125 pages, the trial court rendered the following Memorandum Decision:

> "I have no difficulty in deciding either the law or the facts in this case. Obviously, libelant, fully recognizing its own fault, is attempting to saddle

at least a portion of the blame on either respondent SS GRAND GRACE or MV JANE STOVE, or both. Libelant's contentions, and the arguments in support thereof, are quite resourceful but the evidence on which they are based is shadowy, illusory, and in most instances non-existent. Libelant has completely failed to carry its burden of proof. Its evidence does not rise to the dignity of casting a burden of proof on either of the respondents.

"On the other hand, I find that respondent SS GRAND GRACE has proved her charges of negligence against the libelant as charged in paragraph 2 and in paragraph 3 (a), (b), (c), (d), (e), (h), (i), (k), (l), (m) and (n).[3] The evidence establishes beyond question that the faults and the negligence of the libelant were major in character, were the proximate cause of and fully account for the collision. Any doubts as to the conduct of the respondents, or either of them, must be resolved in their favor.

"The charges of negligence by respondent SS GRAND GRACE against the respondent MV JANE STOVE are not sustained by the evidence.

"As a result of the collision, the SS GRAND GRACE sustained extensive damage to her hull and possibly other damages which were the proximate cause of the faults and negligence of the libelant as aforesaid.

"Proctors for SS GRAND GRACE and MV JANE STOVE shall draft, serve and present findings and interlocutory decree in conformity herewith." (R. 73-74)

It should be noted that the trial court thus inde-

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[3] References are to Pre-Trial Order, R. 54.

pendently found that OTELLO was negligent in various particulars, that these faults were major in character, and were the proximate cause of and fully accounted for the collision, and that OTELLO's charges against GRAND GRACE were not proved. It should also be noted that the trial court was discriminating in its findings of negligence and rejected certain specifications of negligence as charged against OTELLO in paragraph 3(f), (g) and (j) of the pretrial order (R. 54).

After findings prepared by proctors for the prevailing parties were submitted, the court addressed a letter to all counsel, stating:

> "The findings and interlocutory decree presented by Mr. Wood are, in my view, in conformity with my recent memorandum. Both the findings and the decree have been signed as of today. . . ." (Appendix 1)

2. Counsel-Prepared Findings are Findings of the Court.

It is customary for trial courts to call on prevailing counsel for assistance in preparing findings of fact. Such findings, when adopted, have the full force and dignity of findings by the court, and are entitled to the same weight.

Molitor v. *American President Lines,* 343 F.2d 217 (C.A. 9, 1965).

Mississippi Valley Barge Line Co. v. *Cooper Terminal Co.,* 217 F.2d 321 (C.A. 7, 1954).

Atwood v. *Humble Oil & Refining Co.,* 338 F.2d 502 (C.A. 5, 1964).

In the recent *Molitor* case before Judges Madden, Hamley and Koelsch, this Court said:

> "It is immaterial that counsel for the prevailing party, at the request of the court, prepared the findings.
>
> "The only question concerning the facts of this case which this court may appropriately consider is whether any of the essential findings of fact are clearly erroneous. McAllister v. United States, 348 U.S. 19." 343 F.2d 217, 219.

Appellant's brief (pp. 8-9) quotes from *The Severance,* 152 F.2d 916 (C.A. 4, 1945). *The Severance* is fully discussed in the much more recent decision in *Mississippi Valley Barge Line Co.* v. *Cooper Terminal Co., supra,* in which the court states it is perfectly proper for the "busy trial judge" to request counsel for the winning party to prepare findings and conclusions, and that such findings, when adopted, come within the rule of *McAllister* v. *United States,* and cannot be set aside unless clearly erroneous. "Findings of fact submitted by counsel and adopted by the court pursuant to Rule 52(a) are entitled to the same respect as if the court itself had drafted them." 217 F.2d 321, 322-23.

3. Appellant's Opportunity to Submit Supplemental Findings.

Appellant complains that the trial court signed the findings "without affording appellant the prior opportunity to review them or to submit counter proposals." (Appellant's Spec. Er. 8, Br. 6). This is spurious.

The trial judge promptly notified all parties when the findings were signed (App. I). Under FRCP Rule 52(b), and the practice of the trial court,[4] appellant had the right, within 10 days after entry of the decree, to move for amendment of the findings or adoption of additional findings. Appellant simply failed to avail itself of this privilege and is "now in no position to complain of the court's findings simply because they are in accord with those suggested by the other party." *Atwood* v. *Humble Oil & Ref. Co., supra*, at 512.

Appellant's whole attack on the findings reveals the desperate weakness of their position; for it is nothing more than an effort to impugn the integrity of the court. A very similar attack was rebuffed in *Atwood* v. *Humble Oil & Ref. Co.*, 338 F.2d 502 (C.A. 5, 1965):

> "Their whole argument rests on the unfounded assumption that the district judge failed to perform his duty of making findings and conclusions to support the judgment. By assuming that the findings do not represent the real determination and conclusions of the court, but were merely spoon-fed to the court, the plaintiffs impugn the integrity of the district court and make an unwarranted assumption that finds no support in the record." 338 F.2d 502, 512.

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[4] Admiralty Rule 50 of the District Court makes Federal Rules of Civil Procedure applicable to such procedural matters.

II

Findings of Negligence and Proximate Cause are Findings of Fact

Appellant's Point III contends that the trial court's findings of negligence are not findings of fact, but mere conclusions reviewable on appeal.

It is well settled in this Circuit that the trial court's findings of negligence, proximate cause, unseaworthiness, or the absence thereof, are *findings of fact,* which cannot be set aside unless clearly erroneous.

In *Molitor* v. *American President Lines, Ltd.,* 343 F.2d 217 (C.A. 9, 1965), the trial court had found that defendant was not negligent, that the vessel was not unseaworthy, and that no negligence or unseaworthines was the proximate cause of injury to plaintiff. Upon appeal, this Court said, "Contrary to Molitor's assertion, the trial court made complete findings of fact. . . . The only question concerning the facts of this case which this court may appropriately consider is whether any of the essential findings of fact are clearly erroneous." 343 F.2d at 219.

In *Albina Eng. & Mach. Wks., Inc.* v. *Amer. Mail Line, Ltd.,* 263 F.2d 311 (C.A. 9, 1959), the trial court affirmatively found that American Mail had not been negligent in any way. On appeal this Court said:

> "Appellant presents a strong argument that American was negligent at the time the boat was lowered and the injury occurred, but we are satisfied that the trial court did not have to find, as a matter of law, that American Mail was negligent.

> It could have so found, but did not. The finding was not clearly erroneous. And by McAllister v. United States . . . the idea was laid to rest that this court can try admiralty fact questions anew." 263 F.2d at 314.

In *U. S.* v. *Harrison,* 245 F.2d 911 (C.A. 1957), in which a ship sought indemnity from an unloading stevedore, this Court said:

> "Here there are express findings by the trial court that the Stevedore was not at fault or negligent in any manner, and the accident was the sole fault of the agents of the government.
>
> . . . . .
>
> "The findings are not clearly erroneous." 245 F2d. at 914.

In *States S.S. Co.* v. *U. S. et al* (The Pennsylvania), 259 F.2d 458 (C.A. 9, 1957), the trial court made a finding that "petitioner did not use the due diligence required by law to make the vessel seaworthy." This Court, in the decision on rehearing, said, "For the reasons set forth in McAllister v. United States, we cannot go beyond that finding." 259 F.2d at 466.

U. S. v. *The Agioi Victores,* 227 F.2d 571 (C.A. 9, 1955) was a collision case. The trial court had found "there was no negligence on the part of the Agioi Victores," and that there was negligence on the part of the dredge in not keeping a proper lookout and in not giving timely fog signals. As to these findings, this Court said:

> "In reviewing this judgment of a trial court, sitting without a jury in admiralty, we may not set aside the judgment below unless it is clearly erroneous. McAllister v. United States . . ." 227 F.2d at 574.

III

The Findings are Supported by Substantial Evidence

A. The Presumption against the Moving Vessel and in Favor of Anchored Vessel.

The OTELLO, with full use of her engines and rudder, was a moving vessel attempting to navigate out into the fairway. The GRAND GRACE was properly anchored and had been in the same position for two days.

Where a moving vessel collides with an anchored vessel, there is a strong presumption of fault on the part of the moving vessel, and of innocence on the part of the anchored vessel. *The Oregon,* 158 U.S. 186 (1895); *The Louisiana,* 70 U.S. (3 Wall.) 164, 18 L. ed. 85 (1866); *The Blue Goddess,* 199 F.2d 460 (C.A. 7, 1952); *The Europe,* 175 Fed. 596 (D.C. Or. 1909); *Fassio* v. *The E. W. Sinclair,* 207 F. Supp. 700 (S.D. N.Y. 1962).

The Supreme Court said, in *The Oregon*:

> "Where one vessel clearly shown to have been guilty of a fault, adequate in itself to account for the collision, seeks to impugn the management of the other vessel, there is a presumption in favor of the latter, which can only be rebutted by clear proof of a contributing fault. The principle is peculiarly applicable to the case of a vessel at anchor, since there is not only a presumption in her favor, by the fact of her being at anchor, but a presumption of fault on the part of the other vessel, which shifts the burden of proof upon the latter." 158 U.S. at 197.

In *The Louisiana, supra,* a vessel which drifted from

her moorings in a high wind was held solely at fault for collision with another vessel. The Supreme Court said:

> "The collision being caused by the Louisiana drifting from her moorings, she must be liable for the damages consequent thereon, unless she can show affirmatively that the drifting was the result of inevitable accident, or a *vis major*, which human skill and precaution and a proper display of nautical skill could not have prevented." 70 U.S. at 173.

In a more recent case, *The Blue Goddess, supra,* the Seventh Circuit said:

> "It is an established rule in admiralty that when a vessel at anchor is struck by a moving vessel, it is the burden of the moving vessel to exonerate herself from blame." 199 F.2d at 462.

The Europe involved a collision in the Willamette River between a navigating vessel and one at anchor. The Oregon District Court said:

> "It is a rule that a moving vessel must keep out of the way of one at anchor. This because the one at anchor is practically helpless, and is usually so conditioned as to be unable to relieve herself readily in stress of emergency. The rule is applied with great strictness, the vessel at anchor being in a proper place. In such case the presumption of fault lies against the vessel in motion." 175 Fed. at 607.

The trial court, having seen and heard Captain Sundlof testify in explanation of his navigation of the OTELLO, expressly found:

> "15. The Court finds that said collision of the MS OTELLO with the SS GRAND GRACE, and the resulting damage to the vessels, was proximately

caused solely by fault and negligence of the MS OTELLO and those in charge of her navigation, in that she was maneuvering and was a moving vessel and in broad daylight collided with the GRAND GRACE, which was lying properly at anchor in a designated anchorage ground. The OTELLO was presumptively at fault and has wholly failed to overcome the presumption of fault." Finding of Fact 15, R. 78.

This finding is fully supported by the evidence that OTELLO was a moving vessel, had full use of her engines and rudder, was actually navigating, it was broad daylight, the GRAND GRACE was lying properly at anchor, and that OTELLO completely failed to show any *vis major* or inevitable accident to overcome the presumption. See *The Louisiana, supra.*

B. Specific Findings of Otello's Negligence

The trial court also specifically found OTELLO negligent in eleven particulars (Finding 16, R. 78-79). In accordance with Rule 18(3) we shall set forth some of the abundant evidence in support of each specification. To avoid repetition, it should be noted that evidence set forth under one specification may also support others.

FINDING 16(a)

"In allowing OTELLO to drag her anchor, and in failing to let out more anchor chain, and in failing to use her second anchor, so as to prevent dragging, and to avoid collision." (R. 78)

It is elemental that paying out more chain, or drop-

ping a second anchor, are the appropriate precautions to be taken by a vessel dragging her anchor. *Ciudad de Reus* 185 Fed. 391, 395 (C.A. 2, 1911); *The Sapphire,* 11 Wall. 164, 170; *The Anerly,* 58 Fed. 794 (1893). OTELLO's master admitted that the more chain let out, the better the anchor holds (R. 202). He failed to ever let out chain or use his second anchor (R. 220).

OTELLO's master was aware that this vessel was dragging at 2:30 P. M. (R. 166, 199-200). Yet no one was sent to OTELLO's bow to tend the anchors until about 3 P. M.[5] After three or four more minutes (now past 3:00 P. M.), the Captain ordered the anchor heaved in (R. 587). But the Mate did not carry out the order at that time because there was no man in the chain locker (R. 528). So Third Mate Von Endt, the watch officer whose duty was on the bridge assisting the master in navigation, was sent to find someone to go to the chain locker, and when he could find no one he went there himself (R. 218-19, 528-29, 543).

After OTELLO was all clear of the lumber barge MARY OLSEN, she still had half a mile of clear water before reaching the GRAND GRACE (R. 216-17). The charts, and photographic exhibit 40E, show that OTELLO had plenty of sea room. She had lots of time and opportunity to let out chain or drop her second anchor, but did neither.

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[5] Lindstrom, the Chief Mate, was called to the foc'sle to tend the anchor at "two or three minutes to three" (R. 414). Wyman, OTELLO's carpenter who operated the anchor windlass, was not called until 2:55, and reached the bow two or three minutes before 3:00. He recorded the time to collect his overtime pay (R. 584-85).

Strong evidence came from Captain Pullen and Chief Mate Boese, of the ANTINOUS, both impartial witnesses with a grandstand view.

Captain Pullen, an experienced master, testified OTELLO could and should have used her second anchor (R. 1620-27). Chief Mate Boese, also a licensed master, testified that dropping the second anchor is usually done when you are anchored and have high winds. As he stood on the bridge of the ANTINOUS, watching OTELLO's maneuvers, he said to his shipmates: "What is the matter with this ship, why don't they drop the other anchor?" (R. 1720).

The ANTINOUS herself put out a second anchor to hold her position under the circumstances existing at the time (R. 1641-42, 1729).

Numerous court decisions have condemned a dragging vessel for not dropping its second anchor. In *The Anerly,* 58 Fed. 794 (1893), a case relied upon by appellant, the court said:

> "Where there are known indications of the danger of drifting from any extraordinary causes, whether from ice, storm, or position, ordinary prudence requires that *both* anchors be let go; and the omission of this precaution is held to be at the vessel's risk. The Sapphire, 11 Wall. 164, 170; The Energy, 10 Ben. 158; The John Tucker, 5 Ben. 366; The Eloina, 10 Ben. 458; The Lilian M. Vigus, 22 Fed. 747; The Mary Fraser, 26 Fed. 872." 58 Fed. at 795.

FINDING 16(b)

> "In failing to use her engines and twin screws to ease the strain on her anchor and so prevent dragging." (R. 78)

Although the master of OTELLO knew his vessel was dragging, and went to the bridge at 2:30 P. M., he did not even order the engines on standby until 2:42 P. M., and made no use of his engines at all until 2:54 P. M. (OTELLO's engine bell book, Ex. 10B; log translation, Ex. 38; testimony of Sundlof, R. 210-11).

It is fundamental that when a vessel is dragging, the engines can be used to take the strain off the anchor (R. 204). The ANTINOUS, caught by the same wind in the same anchorage area, used his engines to hold position (R. 1642).

FINDING 16(c)

> "In failing to keep OTELLO under control, and in allowing OTELLO to collide with a properly anchored vessel." (R. 78)

As to this, the facts speak for themselves.

Although OTELLO had full use of her engines and twin screws and rudder (R. 220), she was not being navigated under control.

Captain Pullen of the ANTINOUS testified OTELLO "looked like to me she was just paralyzed . . ." (R. 1620); and also, "there she is drifting down like a piece of log" and doing nothing about it (R. 1695). This finding is also fully supported by the evidence set forth under other headings.

FINDINGS 16(d), (e)

"(d) In attempting to navigate OTELLO with one anchor and chain dragging on the bottom."

"(e) In failing to take in her anchor and chain before attempting to navigate and maneuver." (R. 78)

After the delays set forth above, and after 3:00 P. M., OTELLO finally commenced to heave in her anchor. After taking in two shots (180 feet) the anchor chain led across the bow (R. 204-05). Although this happens often (R. 460), OTELLO's windlass was unable to continue heaving in (R. 205, 580).

But this was only a temporary condition. Soon afterwards OTELLO's bow swung to starboard, so that the vessel was headed northerly. The anchor chain was then free, and there was no reason OTELLO could not have taken it in (R. 178, 205-07, 594).

OTELLO's master decided to attempt to navigate out to the fairway (R. 178, 184). But he failed to finish taking in the anchor, and tried to navigate encumbered by the anchor and three shots (270 feet) of chain dragging on the bottom (R. 594).

As already shown, OTELLO had plenty of room in which to navigate, and the court so found. She could have let out more chain and a second anchor to hold her position, or she could have taken in her anchor and navigated freely. Instead, she attempted to navigate encumbered with her anchor dragging on a short chain.

FINDINGS 16(f), (g), (i)

"(f) In failing to use her twin screws to assist in steering so as to avoid collision."

"(g) In failing to navigate out into the fairway at a time when she had ample room and time to do so."

"(i) In failing to use her engines so as to maneuver away from the GRAND GRACE to avoid collision." (R. 79).

These findings are supported by much of the evidence already set forth.

OTELLO was a twin-screw motor ship of 6,400 hp (R. 207). Her twin screws, one on each side of the propeller, gave her strong turning power, and more easily maneuverable than a single-screw vessel (R. 208). She could turn left by going full ahead on her starboard engine while at the same time going astern on the port engine, and vice versa (R. 208, 1719).

After OTELLO had cleared the barge MARY OLSEN, she had a large amount of river in which to maneuver (see charts and Ex. 40E). OTELLO's master admits it was still one-half mile from that point to the GRAND GRACE (R. 216). ANTINOUS was way out in the center of the channel (see supra, p. 2).

OTELLO had full use of her twin screws and her rudder (R. 220). She had room to turn and head into the wind and proceed downstream. She had room to proceed out to the channel astern of ANTINOUS. Or she had room to pass upriver between GRAND GRACE

and the shore, along the same route that JANE STOVE had taken earlier (R. 305-07).

The evidence establishes that OTELLO made no effective use of her engines and rudder. Following is the record of her engine movements, based on her bell book (Ex. 10B) and cross-examination of her master (R. 210-15).

OTELLO ENGINE ORDERS

Time	*Port Engine*	*Starboard Engine*
14:30 (2:30 p.m.) commenced dragging		
14:42	Standby	Standby
14:54		Dead slow ahead
14:56		Stop
15:00 (3:00 p.m.)	Dead slow ahead	
15:02	Stop	
15:03	Dead slow ahead	Slow ahead; half ahead
15:04	Stop	
15:05		Dead slow ahead
15:07		Stop
15:08	Dead slow ahead; Slow ahead	
15:10	Half ahead; full ahead	
15:11	Half ahead; slow ahead	
15:12		Dead slow ahead
15:13	Dead slow ahead	
15:14	Stop	

Time	*Port Engine*	*Starboard Engine*
15:15		Slow ahead; half ahead
15:17	Dead slow astern	Stop; dead slow astern
15:18		Stop; slow; stop
15:19	Stop	Slow ahead; stop
15:20	Full ahead	Half ahead; full ahead
15:21	Stop	Slow ahead; stop
15:22 (3:22) Collision	slow ahead; half ahead	

This establishes that OTELLO never once used her engines in opposition, at even slow or half speeds. At no time was the port engine ever put astern while the starboard engine was ahead (R.. 210, 215). In fact, the port engine was never run astern at all until at 1517, a few minutes before collision, it was run dead slow astern. And the starboard engine was never run full ahead until 1520 when the collision was imminent.

Captain Pullen of the ANTINOUS testified the appropriate maneuver would have been hard left rudder and full ahead to come up into the wind (R. 1620-22). Chief Mate Boese of the ANTINOUS testified that under the existing conditions, between the time OTELLO started to drift and the time she passed the ANTINOUS:

> "A. . . . there was no reason why she couldn't have got back into the channel and found another anchorage. No reason whatsoever." (R. 1717)

Then when OTELLO cleared the ANTINOUS, if her way to the ship channel was blocked by the JANE

STOVE, she had ample opportunity to go full astern, and pass between GRAND GRACE and the shore (where JANE STOVE had previously passed) (R. 305-07). But instead, as JANE STOVE was approaching, OTELLO hesitated with dead slows and stops. Captain Quinn, the experienced pilot in charge of the JANE STOVE, who testified in person at the trial, said that after he passed OTELLO, the OTELLO had "ample room to pass clear of the GRAND GRACE" (R. 294, 310).

Finally, at 3:20., OTELLO did go full ahead on its engines. But OTELLO stopped both engines at 3:21. It was still one minute before collision. Had OTELLO continued at full ahead for that precious minute, she would have cleared GRAND GRACE. For even at a speed of five miles per hour, she would travel 500 feet in one minute, and the point of collision was 200 feet from her stern (R. 186-87).

OTELLO's bell book, and her master's testimony, show that she failed to take any positive, decisive action with her engines to avoid collision. Perhaps this was because the watch officer, whose duty was on the bridge assisting the master and handling the engine telegraphs, was down in the chain locker (R. 218-19, 528-29), and the master alone was blowing whistles, giving anchor orders, giving steering orders, attempting a lookout, and trying to navigate, as well as handling the telegraphs in the wheelhouse (R. 219, 640-41, 648-49).

FINDING 16(h)

"In failing to keep a proper lookout."

OTELLO's situation, dragging in an anchorage with other vessels in the area, clearly called for a most careful lookout. A lookout is required while navigating in a harbor or anchorage (R. 217-18). *The Knoxville City*, 112 F.2d 223 (C.A. 9, 1940).

But no one on the OTELLO was charged with responsibility of keeping a lookout. The only persons on the bow were the chief mate and carpenter, whose duties were to tend the anchors. They made no report to the master that he was getting dangerously close to the GRAND GRACE (R. 392-93). The watch officer, instead of being on the bridge, was down in the chain locker (R. 218-19, 528-29). The only persons on the bridge of OTELLO were the master, helmsman, and the wireless operator, who had no duty as a lookout, but was there merely as a matter of interest (R. 649). The master was attempting to do everything himself (R. 219). Radio Officer Wilen testified:

"Q. I understand you came on the bridge about 3:00 o'clock, or a little bit before 3:00 o'clock.

A. Before 3:00 o'clock, yes.

Q. And you remained on the bridge to the time of collision?

A. Yes.

Q. And the captain was giving the steering orders?

A. Yes.

Q. And the captain was blowing the whistle?

A. Yes.

Q. And the captain was giving anchor orders?

A. Yes.

Q. And the captain was handling the engine telegraph?

A. Yes.

Q. And the captain was watching for the Waterman's ship?

A. Yes.

Q. And the captain was watching for the JANE STOVE?

A. Yes.

Q. And then you told the captain he was getting close to the GRAND GRACE?

A. Yes."

* * * * *

"Q. Were you assisting the captain in the navigation?

A. No, nothing that way.

Q. The captain had no other officer there to assist in the navigation, did he?

A. No. The chief mate, he was standing on the forecastle.

Q. Yes. It isn't your duty as radio officer to assist in the navigation, is it?

A. No, it isn't." (R. 640-41).

OTELLO'S captain was preoccupied with the ANTINOUS and the JANE STOVE, and did not realize he was getting dangerously close to GRAND GRACE until he was warned by the radio officer (R. 392-93).

The evidence clearly establishes that OTELLO did not have such a "free and single-minded lookout," (charged with the duty of lookout and with no other responsibility) as required by decisions of this Circuit. *The Koyei Maru,* 96 F.2d 652 (C.A. 9, 1938); the *Knoxville City,* 112 F.2d 223 (C.A. 9, 1940).

OTELLO's failure to maintain a proper lookout was a statutory fault. 33 U.S.C. § 221. This brings into operation the rule of *The Pennsylvania,* 86 U.S. 125 (1874), imposing on OTELLO the heavy burden of proving that the violation not only *did not* cause the collision, but that it *could not* have caused the collision, — a burden that OTELLO cannot sustain. Gilmore & Black, Law of Admiralty, 404 et seq.

> "The duty of the lookout is of the highest importance. . . . Every doubt as to the performance of the duty, and the effect of nonperformance, should be resolved against the vessel sought to be inculpated until she vindicates herself by testimony conclusive to the contrary." The Ariadne, 13 Wall. 475, 478-79; 20 L. ed. 542.

FINDINGS 16(j), (k)

> "(j) She was not in charge of competent persons."
>
> "(h) Although she had 50 minutes in which to maneuver, and it was broad daylight, and there was ample sea room, she failed to take any effective action to avoid colliding with an anchored vessel." R. 79).

These findings were made by the trial judge after hearing OTELLO's master testify in open court with full opportunity to explain his maneuvers. They are supported fully by the evidence already set forth. We can pity the master of the OTELLO, ineffectively blowing whistles for a pilot for 45 minutes (R. 200), although his radio officer could have called the pilot station in two minutes (R. 644); no one at the anchors for half an hour; his watch officer down below in the chain locker;

trying to handle everything himself on the bridge. But OTELLO cannot be excused from its failure to take any effective action to avoid the collision.

C. Grand Grace Not at Fault.

The trial court found:

> "18. . . . that the SS GRAND GRACE, and those in charge of her navigation, were not negligent or at fault in any of the respects charged by the libelant, or otherwise" (R. 79).
>
> "19. The collision was not proximately caused by failure of the SS GRAND GRACE to let out anchor chain or to use its engines and rudder in the manner that libelant contends GRAND GRACE should have done" (R. 79).

These findings are supported by the fact that GRAND GRACE was lying properly at anchor, and the strong presumption of innocence on the part of the anchored vessel. *The Oregon,* 158 U.S. 186 (1895); *The Europe,* 175 Fed. 596 (D.C. Or. 1909); *Villain & Fassio* v. *The E. W. Sinclair,* 207 F. Supp. 700 (S.D. N.Y. 1962).

In *The Europe,* the court said the reason for the presumption is that the vessel "at anchor is practically helpless, and is usually so conditioned as to be unable to relieve itself suddenly in stress of emergency. The rule is applied with great strictness, the vessel at anchor being in a proper place." 175 Fed. at 607.

In *Villain & Fassio* v. *The E .W. Sinclair,* the Court said: "A vessel properly at anchor, as was the Fassio, is

entitled to the highest degree of privilege. In a collision between a moving vessel and an anchored vessel, the anchored vessel is presumed to be innocent." 207 F. Supp. at 706.

The Court's findings are supported by evidence of the strongest kind. The master of every other vessel involved, including the OTELLO, has testified that under the existing conditions there was no action GRAND GRACE could have taken to avoid the collision.

Captain Pullen, of the ANTINOUS, an experienced, impartial witness with a grandstand view, testified:

> "Q. Now, from your point of observation was there anything the Liberty ship GRAND GRACE could do?
>
> A. Well, I couldn't see what, anything the GRAND GRACE, what the GRAND GRACE could have done." (R. 1647-48).

Chief Mate Boese, of the ANTINOUS, an experienced seaman with Master's license, was a disinterested witness who watched the whole occurrence. He testified:

> "Q. Well, you have had a lot of experience at sea, and you were right you might say at a grandstand position to view this thing. This is asking for an opinion, but what steps do you think could have been taken by any of the vessels to have avoided this collision; what ones do you feel should have taken steps and could have taken steps?
>
> A. When this Swedish ship, when they saw that they were dragging anchor, they should have dropped their port anchor or got steam up and got back into the channel and moved anchorage, or even

drug their anchor downstream. If they drug it one way it sure would drag the other way. Just like a ship docking, you drop your anchor to slow it up."

* * * * *

"Q. Do you think there was any fault on the part of the Liberty ship (GRAND GRACE)?

A. I do not." (R. 1722).

Captain Christoffersen, Master of the JANE STOVE, testified:

"Q. Now, as you were approaching the GRAND GRACE and the Swedish ship, on your port side, you came up abeam of them, and you saw that the GRAND GRACE was anchored, and you knew she was down?

A. Yes.

Q. And you saw the other ship drifting down upon her, did you not?

A. Yes, sir.

Q. And you knew the conditions of the wind and the weather?

A. Yes.

Q. You saw the whole thing?

A. Yes, right.

Q. Was there anything that the GRAND GRACE could have done that would have avoided this collision?

A. I don't think so" (R. 1407-08).

Finally, and this is what brands OTELLO's contentions as frivolous, even OTELLO's Master, Captain Sundlof, testified that he did not expect or think that GRAND GRACE could have done anything to avoid the collision:

"Q. What did you want the GRAND GRACE to do?

A. Nothing at all whatsoever; so far she couldn't do very much. Probably she could strike the anchor, but I don't know how much anchor she had out in the water, but probably had almost everything. She couldn't do—in this case I don't think she could do anything" (R. 360).

Appellant's brief tries to create the impression that GRAND GRACE was aware of danger of collision for nearly an hour, and did nothing about it. This is false, and contrary to the facts found by the court.

Although OTELLO commenced to drag at 2:30 P.M., *she* did nothing about it until after 3:00 P. M. Sometime after 3:00 P. M., and when still over half a mile from GRAND GRACE, with full use of her engines and rudder, OTELLO commenced to navigate to pass out to the fairway (R. 216). And that is just what GRAND GRACE thought she was doing (R. 1073-75; 1311-13, 834). It was only at the very last moment, when OTELLO was very close to GRAND GRACE, that there was any reason for GRAND GRACE to be alarmed, and then there was no time to do anything (R. 1076; 1313-14). This is established by the testimony of both the OTELLO and GRAND GRACE.

At the trial Captain Sundlof testified that he planned to pass clear of ANTINOUS' stern and proceed into the channel, and if it had not been for the JANE STOVE coming along he could have done this (R. 183-84). There was no danger of collision until the JANE STOVE proceeded to cross his bow (R. 231-32).

"Q. Then you had plenty of room to pass out between the ANTINOUS and the GRAND GRACE?

A. Yes.

Q. And you had the use of your engines and your rudder?

A. Yes.

Q. And you would have had no difficulty passing into the clear?

A. No.

Q. You say no, you mean . . .

A. We had no trouble, no problem.

Q. Or if the JANE STOVE had stopped and let you carry out your intended maneuver, you would have had no problem?

A. No.

Q. But it was when you became aware that the JANE STOVE didn't and she crossed your bow, then that put you in difficulties?

A. Yes." (R. 247-48).

And in his deposition, Captain Sundlof testified that he had plenty of room to pass between ANTINOUS and GRAND GRACE, and he did not become concerned about the GRAND GRACE until JANE STOVE forced him to stop and go astern, "and then before we could get speed and go up again then it was too late." He was then only about 75 meters from the GRAND GRACE (R. 391-92).

OTELLO's Chief Mate, Lindstrom, testified that the collision occurred in "about one minute" after JANE STOVE passed OTELLO's bow (R. 429). Her carpenter, Wyman, testified the collision took place "only a few seconds" after JANE STOVE passed (R. 592).

Second Mate Rundquist saw the JANE STOVE approaching about 150 feet off, and GRAND GRACE was about 200 feet distant, and "from there it was only a matter of seconds since I came out till the collision" (R. 479-80).

The foregoing coincides with GRAND GRACE's version that there was no reason to apprehend danger of collision until OTELLO was very close, and then there was no time to do anything.

Captain Wang, master of the GRAND GRACE,[6] testified the OTELLO appeared to be leaving her anchorage to proceed out to the ship channel (R. 1073-74). This was not unusual, — while the GRAND GRACE had been at anchor other vessels had passed her moving up and down the fairway (R. 1074). There was plenty of room for OTELLO to pass between GRAND GRACE and the ANTINOUS, and he was not aware that OTELLO would have any difficulty passing to the fairway (R. 1074-75). He was first aware of danger when OTELLO stopped its engines very close, at a distance of about 100-150 feet (R. 1075-76). He then testified:

> "Q. From the time that the OTELLO appeared to stop his engines and you saw there was danger of him hitting you, how long was it from then till he hit your ship?
>
> A. A couple of minutes, about.
>
> Q. Did you have time to take any action to avoid the collision?
>
> A. At no time.

---

[6] The master, Hao Wang, and the mate on watch, Wang Yu Teh, were on the bridge doing routine work checking compasses (R. 1071).

Q. Was there any action you could take to avoid the collision at that time?

A. There was hurry. The time is so hurry I have no time . . ." (R. 1076-77).

Third Mate Wang Yu Teh, the watch officer, testified that OTELLO was headed toward the fairway, and she was moving, and there was no danger to the GRAND GRACE until OTELLO was 100-150 feet distant when she stopped her engines (R. 1313-14). He testified that OTELLO was moving and was using its engines, and was proceeding to the fairway. Other ships had passed by closer than that. He felt no danger until OTELLO was 100-150 feet (R. 1353-54).

Likewise, Chief Mate Sha testified, "Actually, she is shifting anchorage, and if she is going to fairway she would have been all right, I should think. But afterwards she stopped on our bow, like this, in this position." From OTELLO's position 3, at which there was no danger, to OTELLO's position 4, (collision) on the diagram drawn by Chief Mate Sha, and attached as Appendix A to appellant's brief, was "only about two minutes, very quick . . ." and "we got no time to do anything" (R. 837-38, 842).

GRAND GRACE was not aware that OTELLO was dragging her anchor. This was only learned after the collision (R. 854). GRAND GRACE was headed westerly. OTELLO was headed northerly with her starboard side toward GRAND GRACE. It was OTELLO's port anchor that was out, and therefore GRAND GRACE could not see that the anchor chain was out on OTELLO's port side.

OTELLO's charges against GRAND GRACE are essentially two: (1) that GRAND GRACE should have slacked off chain; and (2) that GRAND GRACE should have used her rudder and engines to steer away from collision. The trial court found these contentions to be "quite resourceful, but the evidence on which they are based is shadowy, illusory, and in most instances non-existent. Libelant has completely failed to carry its burden of proof." (Mem. Dec., R. 74; Finding 21, R. 79).

1. *Slacking off Chain.* In the strong wind, GRAND GRACE's anchor chain was held by the windlass brake, and also secured by a stopper, consisting of a turnbuckle and shackle (Ex. 116-A; R. 1293-94). To pay out chain it would be necessary first to start the engines and come ahead with the ship so as to put slack in the chain, then release the turnbuckle and shackle (R. 1290-94). There was no time to do this. As Captain Wang testified: "There was hurry. The time is so hurry, I have no time to slacken my starboard chain because I have to loose the chain stopper, you see, first. We have standby engine. The engine takes three or four minutes, you see" (R. 1076-77).

In any event, there is no evidence whatever that slackening the anchor chain would have avoided the collision. Captain Wang testified that even if he had slackened chain it would have remained tight in the strong wind and close to the surface of the water, and OTELLO would have hit the chain and come against GRAND GRACE (R. 1077).

2. *Using Rudder to Veer Ship.* First, the rudder would have no effect in moving the GRAND GRACE without her engine also going ahead. The vessel was windrode and would lie where the wind held her, regardless of rudder position (R. 849). Second, when a vessel is at anchor in a strong wind, use of the engines thrusting water against the rudder will move the *stern,* but will have little or no effect on the *bow,* which is held by the anchor chain. OTELLO's brief (p. 15) mentions that Captain Pullen, Master of the ANTINOUS, used his rudder and engines to veer the ANTINOUS. But ANTINOUS had her engines going at the time, and he veered her *stern* (R. 1647, 1675). Captain Pullen also testified that, even using the engines against the rudder, it does not change the position of the *bow*:

> "Q. You mentioned that as the OTELLO came by you gave your ship left rudder, kicked the engine so that moved your stern northward?
>
> A. Northward, right . . .
>
> Q. But actually with the bow anchored it doesn't change the position of the bow, for example, does it?
>
> A. No, it does not." (R. 1690).

It was with GRAND GRACE's bow that OTELLO collided.

Third, as set forth above, there was no time for this. GRAND GRACE's engine room was on usual anchor watch. It would have taken at least four minutes to prepare the engines to go ahead (Testimony of Ch. Eng., R. 1033).

Fourth, even if GRAND GRACE could have swung her bow, OTELLO still would have collided with her. The actual point of collision was nearly midships on the OTELLO, 200 feet forward of her stern (Sundlof, Trial testimony, R. 186-87; Drawing Ex. 39). Therefore, even if GRAND GRACE could have swung her bow as much as 150 feet in either direction there would still have been a collision. There is no evidence whatever that, even given plenty of time and use of her engines, GRAND GRACE could have swung such a distance.

Finally, in what direction should GRAND GRACE have swung her bow, assuming she could have done so? OTELLO had been maneuvering her engines, at times ahead and at times astern, just before the collision. GRAND GRACE could not guess what OTELLO's next maneuver might be. For GRAND GRACE to have turned in either direction could well have caused greater damage.

The quotation from Knight on Seamanship (Ap. Br. p. 15) is totally inapplicable to the facts. It does not apply where a vessel is windrode so that the heading is controlled by the wind rather than the current, and it also assumes plenty of time.

Appellant's suggestion (Br. p. 6, 16) that the trial court failed to draw adverse inferences from GRAND GRACE's "failure to produce her master or pilot at the trial, or to take their de bene esse depositions" is absurd. The master of the vessel was Captain Hao Wang, whose de bene esse deposition is in the record (R. 1048-1119). There was no pilot aboard the GRAND GRACE.

and had been no pilot for two days prior to the collision (R. 1059-61). As for Sha, the Chief Mate, he was examined by appellant's proctors *ad infinitum* at three different sessions of discovery deposition, all of which is in evidence (R. 795-867; 869-891; 1219-1248).[7]

Any fair reading of the authorities cited by appellant (Br. p. 16-17) shows they are wholly inapplicable to the circumstances of the present case. For the most part, they involve situations where a helpless vessel dragged for several hours toward one that could have moved out of the way. This was not the situation of OTELLO, which was navigating with full use of her engines and rudder, and appeared to be going out to the fairway, and the danger of collision with GRAND GRACE only arose a few moments before the actual collision. As said in *Fassio* v. *The E. W. Sinclair:* "Any duty to pay out more anchor must depend upon the circumstances; i.e., whether the vessel has the time and opportunity to do so." 207 F. Supp. 700, 713. Here the trial court has expressly found GRAND GRACE not negligent.

Finally, as found by the trial court based on abundant evidence, the faults and negligence of OTELLO "were flagrant and major in character and were the proximate cause of and fully account for the collision" (R. 80). Therefore, if there were any doubts as to the conduct of the GRAND GRACE, they should be resolved in her favor. *The Victory,* 168 U.S. 410, 423 (1897); *The Oregon,* 158 U.S. 186, 197 (1895).

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[7] The second session was adjourned because of illness (R. 889-90) and appellant had full opportunity to complete the deposition at a third session (R. 1219-48).

LITIGATION EXPENSES

Appellant complains (Br. p. 28) of the allowance of $1,795.12 litigation expenses to appellee Grace Navigation Corporation.

This was fully within the discretion of the trial court. In view of the finding, "the evidence upon which libelant's contentions are based is shadowy, illusory, and in most instances non-existent," (R. 74-79) the court would have been justified in also allowing GRAND GRACE's claim for reasonable attorneys' fees and traveling expense for depositions. *Vaughan* v. *Atkinson*, 369 U.S. 527 (1962); *Sprague* v. *Ticonic Bank*, 307 U.S. 161, 164 (1939). But the court denied that portion of GRAND GRACE's claim. (Order., R. 85-86). It would therefore seem that GRAND GRACE, rather than OTELLO, has cause to complain on this issue.

In any event, the litigation expenses allowed were largely deposition costs which could have been claimed and allowed as ordinary taxable costs had they not been allowed as litigation expenses (See details of Claim, R. 119-21).

CLAIM FOR DAMAGES UNDER RULE 24

Appellee Grace Navigation Corporation hereby requests this Court, in its discretion, to allow damages for delay pursuant to Rule 24(2), (4) of this Court. At the outset of this appeal, appellant was notified that damages for delay would be claimed (R. 138-39).

This is an appropriate case for the award of damages for delay under Rule 24, because of the following factors:

1. The trial court's finding that appellant's contentions are based on evidence "shadowy, illusory, and for the most part non-existent" (R. 74-79).

2. The strong presumption of fault against OTELLO as the moving vessel and the strong presumption of innocence in favor of GRAND GRACE as the anchored vessel.

3. The trial court's detailed fact findings of fault on the part of OTELLO and innocence of the GRAND GRACE.

4. The rule of *McAllister* v. *United States* that, "these findings can not be set aside unless clearly erroneous."

5. The overwhelming substantial evidence in support of the trial court's detailed findings of fact.

6. Appellant's delay and failure to follow the rules of this Court in its appeal.

Although the final decree was entered July 19, 1965, the notice of appeal was not filed until September 10, 1965 (R. 156), and appellant did not file the record with this Court until December 6, 1965, and did not file its brief until April 4, 1966.

Although FRCP Rules 75(a), (d) required that appellant file its designation of record and statement of points *promptly* after the notice of appeal, appellant did not file its designation of record until November 17, 1965 (R. 156), and did not file statement of points until December 8, 1965.

Appellant has ignored Rule 18(f) of this Court requiring that appellant's brief contain an appendix setting forth table of exhibits.

It is submitted that appellant's appeal is groundless and can only be presumed to have been taken for purposes of delay.

CONCLUSION

This case is much like one where a moving automobile collides with one that is properly parked.

For the reasons set forth, the decree of the District Court in favor of the GRAND GRACE and against OTELLO should be affirmed, with damages for delay.

Respectfully submitted,

WOOD, WOOD, TATUM, MOSSER & BROOKE
ERSKINE B. WOOD
Proctors for Appellees
SS GRAND GRACE and
Grace Navigation Corporation

APPENDIX I

UNITED STATES DISTRICT COURT
DISTRICT OF OREGON
Portland, Oregon 97205

JOHN F. KILKENNY

United States District Judge

January 5, 1965

Mr. Erskine B. Wood
Attorney at Law
1310 Yeon Building
Portland, Oregon 97204

Mr. Kenneth E. Roberts
Attorney at Law
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Portland, Oregon 97204

Mr. Richard C. Helegson
Attorney at Law
1200 American Bank Building
Portland, Oregon 97204

Gentlemen:

Re: REDERI A/B SOYA v. SS GRAND GRACE, et al, Civil No. 64-27

The findings and interlocutory decree presented by Mr. Wood are, in my view, in conformity with my recent memorandum. Both the findings and the decree have been signed as of today and a trial date fixed on the issue of damages for the week of February 22nd.

At this time, I exercise my discretion against the allowance of attorney fees to either of the claimants. Evi-

dence on reasonable expenses to be taxed as costs may be presented at the time of the hearing.

Very sincerely yours,
/s/ JOHN F. KILKENNY

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

ERSKINE B. WOOD
Of Proctors for Appellees

No. 20591

United States Court of Appeals

For the Ninth District

REDERI A/B SOYA, as owners of the Swedish Motor Vessel *OTELLO*,

Appellant,

vs.

The SS. *GRAND GRACE*, her Engines, etc. and her Owners, GRACE NAVIGATION CORPORATION,

and

The MV *JANE STOVE*, her Engines, etc., and her Owners, LORENTZENS SKIBS A/B,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT, FOR THE DISTRICT OF OREGON, HONORABLE JOHN F. KILKENNY, DISTRICT JUDGE.

REPLY BRIEF OF THE *OTELLO, REDERI A/B SOYA*, APPELLANT

MAUTZ, SOUTHER, SPAULDING, KINSEY & WILLIAMSON,
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KENNETH E. ROBERTS,
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DAVID C. WOOD,
of Counsel.

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No. 20591

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For the Ninth District

Rederi A/B Soya, as owners of the Swedish Motor Vessel *Otello*,

Appellant,

vs.

The SS. *Grand Grace*, her Engines, etc. and her Owners, Grace Navigation Corporation,

and

The MV *Jane Stove*, her Engines, etc., and her Owners, Lorentzens Skibs A/B,

Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON, HONORABLE JOHN F. KILKENNY, DISTRICT JUDGE.

REPLY BRIEF OF THE *OTELLO, REDERI A/B SOYA*, APPELLANT

Statement

The appellant, *Otello*, submits this brief in reply to the respective briefs of appellee, *Jane Stove*, and of appellee, *Grand Grace*.

The *Otello* regards the *Jane Stove* as the active faulty offender in this collision and the *Grand Grace* as the passive faulty offender. Both appellee-offenders have adopted somewhat common grounds of defense to which we will reply first

she order her engines in readiness for use and that she station seamen at the anchor windlass in preparation for the simple operation of releasing the brake so as to pay out anchor chain if it became necessary. *Grand Grace,* being a steamer, would require 15 minutes or a half hour to warm up her engines for use;* and in respect of the seamen attending the windlass, it would require no more than a minute's time for him to comply with an order to stand by (R. 1291). These simple operations were not undertaken by the *Grand Grace,* so that when the *Otello* could not work herself clear into the channel because of the approach of the *Jane Stove,* the *Grand Grace* was negligently powerless to do anything to avoid the dragging *Otello.*

(c) *The principle of McAllister* v. *United States does not help the appellees.* It is not unexpected that appellees resort to *McAllister* v. *United States,* 348 U. S. 19 (1954), and its ruling that findings of fact are not to be modified unless clearly erroneous. But this Court, we need hardly mention, has upset fact findings as clearly erroneous where the primary facts admit of but one reasonable conclusion, as they do here, with respect to the *Grand Grace* and to the *Jane Stove. Hoppe* v. *Rittenhouse,* 279 F. 2d 3, 9 (9 Cir. 1960). Along similar lines, is the case of *Moran Bros., Inc.* v. *W. R. Yinger,* 323 F. 2d 699 (10 Cir. 1963), where the court stated, 702-703:

> "Thus, while there is some evidence tending to support the court's finding, we are, nevertheless, on the entire evidence left with the definite and firm conviction that a mistake has been committed: It therefore follows that the finding of fact in question is clearly erroneous."

The foregoing cases accord with the *United States* v. *Gypsom Co.,* U. S. 364, 395 (1948).

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* Her engines could have been ready at an instant if they had been kept ready rather than completely shut down (R. 949).

The appellees also seem to find comfort in an attempted criticism of Supreme Court Admiralty Rule 46½, requiring the enunciation of specific findings of fact. The importance of the rule is self-evident, particularly in collision cases where facts are so preponderantly decisive. Adherence to this rule insures that the Appellate Court will have a clear and complete picture of the basis of a trial Court's decision. It enables an appellant duly to assert its rights of appeal and gives the Appellate Court an adequate basis to consider errors complained of in the findings. *Matton Oil Transfer Corp.* v. *The Dynamic, et al.*, 183 Fed. 999 (2nd Cir. 1941). We stand on this Court's ruling in *Gypsum Carrier, Inc.* v. *Handelsman*, 307 F. 2d 525, at 532, where the Court stated:

> "We agree with appellant that findings in admiralty (as in civil litigation generally when tried to the court when sitting without a jury) should be sufficiently specific to permit fair appellate review of the manner in which the trial court resolved the issues upon which its judgement depends."

The foregoing accords with this Court's ruling in the same year in *Daido Lines* v. *Thos. P. Gonzales Corp.*, 299 F. 2d 669 (9th Cir. 1962).

d. *Findings of a Trial Court, unless independently composed, are subject to especially close scrutiny.*

Appellees' counsel do not dispute that the trial court accepted *in toto* the findings proposed by them, but irrelevantly argue that this was "customary". Custom cannot abrogate a Rule of the Supreme Court of the United States. Equally important is the fact that such "adopted findings are subject to closer scrutiny on appeal, as against those composed by the Court itself (*Otello* main brief, 8-10). Counsel's proposed findings are subject to the natural infirmities of interested advocacy, whereas making findings is purely a judicial function which is attended with strict impartiality. Comments of the Hon. E. Otis, at the Judicial Conference of the 8th Circuit, 1 F. R. D. 83, 85.

II. The cases relied upon by *Grand Grace* are inapplicable, and the "findings" in her favor are clearly erroneous.

The Oregon, 158 U. S. 186 (1895), and *The Europe*, 175 Fed. 596 (D.C. Or 1909) (*Grand Grace* brief, pp. 14-15), both involved vessels underway at 15 knots which were only seen by the anchored vessels seconds before the collision. Obviously the anchored vessels did not have time to take any action.

Villain & Fassio E. Compagnia v. *Tank Steamer E. W. Sinclair*, 207 Fed. Supp. 700 (S.D.N.Y. 1962) (*Grand Grace* brief, pp. 14, 28, 38) involved the *Sinclair*, which, proceeding at high speed in dense fog, made a sudden and unexpected course change near an anchored vessel, who had only a few seconds warning. It does not help appellees, since the *Otello* dragged slowly towards the *Grand Grace* for an hour and the *Grand Grace* took no action.

The Blue Goddess, 199 F. 2d 460 (C.A. 7 1952) (*Grand Grace* brief, pp. 14, 15) involved a collision between two unmanned pleasure craft.

The Louisiana, 3 *Wallace* 164 (1866) (*Grand Grace* brief, pp. 14-16) involved a collision with a grounded immobile vessel.

Finding of Fact 15 (pp. 15-16 *Grand Grace* brief), states the conclusion that the *Otello* was negligent, and solely at fault for the collision because she was a moving maneuvering vessel and collided with a vessel lying properly at anchor (R. 78). That is wrong on two counts.

The *Otello* was windborne and was not in full control of her movements, as an ordinary moving vessel would have been (R. 168-169). Also, she was not a moving vessel in the true sense of the word for her anchor was down (352-353). A vessel in such straits as was the *Otello* is particularly vulnerable when trying to maneuver out of any

anchorage and is given special consideration by the courts. *Isaac T. Mann*, 63 F. Supp. 339 (S. D. N. Y. 1945); *The Arfield*, 42 F. 2d 745 (E. D. La. 1930).

The *Grand Grace* was not "lying properly at anchor" under the circumstances. Her engines were not ready to be used (R. 842).

Appellee *Grand Grace* apparently concedes that if the engines had been in a state of readiness, the *Grand Grace* might have maneuvered clear of the *Otello* (*Grand Grace brief*, pp. 36-37). Furthermore, the *Grand Grace* did not take appropriate action to avoid the collision by using her rudder to sheer her clear (R. 842, 843).

In *Finding 16(a)* (referred to *Grand Grace* brief, p. 16), the trial Court held that the *Otello* was negligent in dragging, not letting out more chain, and failing to use her second anchor. The *Otello*, as directed by her local pilot, had been securely anchored on the same anchor for two days prior to the collision (R. 165). Her performance was better than the *Grand Grace* and *Jane Stove*. Both the latter used only one anchor on the date in question (R. 284-290, 842). The *Jane Stove* dragged her anchor on three separate occasions on the date in question (R. 284-290), and not once did she use a second anchor or let out extra chain to hold her position (R. 284-290). Rather, she picked up her anchor, maneuvered to a new position. The *Grand Grace* herself never let out extra chain or dropped a second anchor (R. 842).

Although anchored on a long scope of chain, *Otello* started to drag slowly and this was promptly detected (R. 242). A pilot could not put out to her to change her position and *Otello's* pilot signals went unheeded (R. 174).

Since it took her an hour or more to drag one-half mile upstream to *Grand Grace's* position, *Otello* was dragging slowly at only about 1/10 of a length per minute.

Her master, in his seaman's judgment, decided he had best move ahea l on his chain and let go a second anchor near his first anchor; that dropping a second anchor at once, necessarily on short scope, would not help (R. 176). If it were done, there was danger of the chains fouling (R. 242). As his planned operation continued his chain jammed across the stem (R. 176).

So *Otello* continued her slow drag, broadside to the wind (heading north), sounding danger signals, as she neared the *Antinous* (R. 176-181).

Appellee *Grand Grace* states (p. 17) that after *Otello* cleared the *Mary Olsen* (a barge anchored on *Otello's* port quarter), *Otello* still had half a mile of clear water before reaching the *Grand Grace*. Appellee's own witnesses indicated that the distance between the *Mary Olsen* and the *Grand Grace* was only about one-quarter mile, or about three ship lengths (Ex's 15D, 12AA). *Otello*, upon clearing the *Antinous*, then saw her chance to stop her drag toward *Grand Grace* and to go ahead to the north past *Antinous'* stern (R. 179). But the *Jane Stove* in unnecessarily heading between *Antinous* and *Otello* prevented Otello from moving northward into the clear (R. 179).

III. *Jane Stove's* mishandling clearly contributed to this collision and this is clearly demonstrated by the controlling evidence.

Appellee *Jane Stove contends* (pp. 8 and 9) that it was incumbent upon the *Otello* to prove that "the *Jane Stove* course took her sufficiently close to the *Otello* to critically impede the latter's navigation;".

The *Jane Stove's* master plotted the course of the *Jane Stove* on Exhibit 21A, 207 (App's Main Br. App. B).* This

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* After consultation with attorney for the *Jane Stove* (R. 1394-1395, 1409).

exhibit clearly shows that the *Jane Stove* navigated well south of the main channel in Anchorage 1 (*Otello* Main Brief, pp. 19-20). The *Jane Stove* log book contains an entry made after consultation with attorney for the *Jane Stove* (R. 1419) which reads as follows:

> "Approximately 1530 hours passed the *Otello* approximately one hundred meters off (which) had dragged and drifted down upon another anchored vessel, the *S.S. Grand Grace*" (R. 1406).

Jane Stove's attempt to dispute that testimony by references to the testimony of various witnesses not aboard the *Jane Stove* is plainly misdirected. Captain Pullen, master of the *Antinous* (*Jane Stove* brief, p. 11) testified: "* * * I know what I am on, I don't know exactly if she (*Jane Stove*) is on the range because I am not on that ship looking at the range" (R. 1629).

Jane Stove (p. 11) contends that the *Jane Stove* passed 900 feet (about two ship lengths) off the *Otello*. This hopeful estimate was the greatest given by any witness who testified either *de bene esse* or at trial. Even so, a passing distance of two ship lengths is dangerously close.

But, *other witnesses testified that the Jane Stove passed 50 feet off the bow of the Otello* (R. 592), *75 feet off the bow of the Otello* (R. 183, 427), *300 feet off the bow of the Otello* (R. 1406, *Jane Stove's* Master; Ex. 209, *Jane Stove* Deck Log Book). *Jane Stove's* interference could not be plainer.

Jane Stove's references (pp. 11 and 12) to the testimony of Captain Sundlof of the *Otello* are absurd. Captain Sundlof testified explicitly that the *Jane Stove* navigated on a course parallel to the Astoria Range, but not on the Astoria Range (Ex. 39, R. 191, 364).

He further testified that the *Jane Stove* cut across the anchorage grounds as she approached the *Otello* (R. 191,

364, Ex. 39). That is the controlling feature of Sundlof's testimony.

Jane Stove wrongly contends that the *Otello* made no effort to maneuver until very shortly before the collision (*Jane Stove* brief, pp. 13 and 14). That fact contention is contradicted by virtually every fact witness involved, even those adverse to the interests of the *Otello* (Ex. 10B—*Otello* Bell Book, Exs. 12AA, 12BB, 13G—diagrams by Captain and Chief Mate of *Grand Grace*, R. 216, 1073-1075—testimony of Captain Wang of *Grand Grace*, 1311-13—testimony of *Grand Grace* watch officer, 834). We refer to the overwhelming testimony that the *Otello* was maneuvering with her engines for more than thirty minutes before the collision (Ex. 10A, 15A, R. 216, 834, 1073-1075, 1311-13). The *Grand Grace* (brief, pp. 23-23) clearly sets forth the numerous maneuvers of *Otello* attempts to maneuver into the fairway.

The *Otello* could not maneuver to the westward, because the wind had forced her head to the north (R. 178). She did not head southward because this would take her into uncharted waters, well outside the channel (Ex. 4A, R. 298, 314-316).

Jane Stove admits (pp. 15-16) that the *Otello* sounded whistle signals, but contends that they were ambiguous, or inadequate. Apparently, *Jane Stove* was *alone* in doubt in this situation of plain danger (R. 841, 1713-1714, 1734-1735, 1284, 1313-1314). If one accepts her "doubt" she nevertheless should have held up (Pilot Rules 80.1, 80.7(b).)

Furthermore, the *Jane Stove* stresses in its attempted defense the alleged good repute and knowledgeability of her pilot (*Jane Stove* Br., p. 9). But the proved facts as to the handling of the *Jane Stove* by her pilot are the decisive factors. The claimed presence of the *Jane Stove* pilot on the port wing of that vessel is disputed by the *Jane Stove's* watch mate. The watch mate places the *Jane*

Stove pilot *not* out on the port wing of the bridge of that ship, but *on the starboard side in the wheel house* (R. 1496). Again, the Master of the *Jane Stove* testified that the *Jane Stove* did not pass off the *Otello's* bow at the allegedly generous distance given by the *Jane Stove* pilot, but passed only 300 feet off the bow of the *Otello* (R. 1406). Further, the *Jane Stove's* Master testified that the *Jane Stove* cut through the anchorage (Ex. 21A, 207). These are facts which condemn the *Jane Stove* in fault.

Additionally, it is noteworthy that of the 1798 pages of testimony taken in this case, only 116 pages consists of "live testimony" taken before the District Court.

Conclusion

We submit that the trial court's decree should be reversed to adjudge the appellees *Grand Grace* and *Jane Stove* responsible for the *Otello's* collision with the *Grand Grace.*

Respectfully submitted,

Mautz, Souther, Spaulding, Kinsey & Williamson,
Hill, Betts, Yamaoka, Freehill & Longcope,

Proctors for Appellant.

Kenneth E. Roberts,
Eugene F. Gilligan,
David C. Wood,
of Counsel.

Dated: June 27, 1966.

Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

David C. Wood

Appendix A*

OTELLO EXHIBITS

Exhibits	Identified	Offered	Received	Rejected
1	—	68	68	
1A	332	69	69	
1B	332	69	69	
1C	332	69	69	
1D	334	69	69	
1E	334	69	69	
1F	338	69	69	
1G	348	69	69	
1H	348	69	69	
1I	397	69	69	
2	—	68	68	
2A	415	69	69	
2B	456	69	69	
3	—	68	68	
3A	477	69	69	
3B	487	69	69	
3C	507	69	69	
3D	512	69	69	
4	—	68	68	
4A	524	69	69	
4B	533	69	69	
4C	533	69	69	
4D	533	69	69	
4E	534	69	69	
4F	537	69	69	
4G	537	69	69	
5	—	68	68	
5A	567	69	69	
5B	578	69	69	
6	—	68	68	
6A	586	69	69	
6B	595	69	69	
7	—	68	68	
8	—	68	68	
8A	629	69	69	
8B	629	69	69	
8C	636	69	69	

* Appendix to exhibits was inadvertently omitted in appellant's main brief.

Exhibits	Identified	Offered	Received	Rejected
9	—	68	68	
10	—	68	68	
10A	675	69	69	
10B	676	69	69	
10C	682	69	69	
10D	683	69	69	
10E	683	69	69	
10F	684	69	69	
11	—	68	68	
11A	703	70	70	
11B	705	70	70	
11C	708	70	70	
11D	711	70	70	
11E	715	70	70	
12	—	68	68	
12A	1153	70	70	
12B	1172	70	70	
12C	1176	70	70	
12D	1193	70	70	
12E	1193	70	70	
12F	1193	70	70	
13	—	70	70	
13A	814	70	70	
13B	816	70	70	
13C	819	70	70	
13D	821	70	70	
13E	824	70	70	
13F	829	70	70	
13G	840	70	70	
13H	854	70	70	
13I	855	70	70	
13J	862	70	70	
14	—	68	68	
14A	982–83	68	68	
15	—	69	69	
15A	1311	69	69	
16	—	68	68	
16A	1293	70	70	
17	—	68	68	
17A	1271	70	70	
18	—	68	68	
19	—	68	68	
19A	951	69	69	
20	—	68	68	

Exhibits	Identified	Offered	Received	Rejected
21	—	68	68	
21A	1408	70	70	
21B	1414	70	70	
22	—	68	68	
22A	747	70	70	
22B	773	70	70	
23	—	68	68	
24	—	68	68	
24A	1487	70	70	
24B	1487	70	70	
24C	1490	70	70	
24D	1495	70	70	
25	—	68	68	
26	—	68	68	
27	—	68	68	
27A	1548	70	70	
28	—	68	68	
28A	1565	70	70	
28B	1571	70	70	
28C	1587	70	70	
29	—	68	68	
29A	1606	70	70	
29B	1657	70	70	
29C	1664	70	70	
29D	1690	70	70	
30	—	68	68	
30A	1718	70	70	
31	—	68	68	
31A	1763	70	70	
32	—	69	69	
32A	1785	70	70	
33	—	69	69	
33A	1804	71	71	
33B	1810	71	71	
33C	1852	71	71	
34	—	71	71	
35	—	71	71	
36A	—	71	71	
36B	—	71	71	
37	—	197	197	
38	—	71	—	
39	—	71	—	
40 A–G	—	267	267	
41 A–J	—	71	71	

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44	—	71	71	
45	256	268	268	
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103	819	68	68	
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No. 20,592

United States Court of Appeals

For the Ninth Circuit

DANIEL A. ROBIDA,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S OPENING BRIEF

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STATEMENT OF THE CASE:

MR. ROBIDA DID NOT RECEIVE A FAIR HEARING

1. Commissioner's Notice of Deficiency and Assessment Was Based on Fraud and a Failure to File and on Failure to Keep Adequate Records.

September 18, 1962, Internal Revenue Service mailed a notice, addressed to Robida at Wiesbaden, Germany, of determination of tax liability and deficiencies in tax for the years 1956 through 1961 (CT 44),[1] assessing penalties for fraud under Internal Revenue Code § 6653(b) and failure to pay on estimated income under Section 6654. Said notice advised Robida that the Government had made a jeopardy assessment in the amount of $71,143.00. Actually, the Government seized over $77,000.00 (RT 6, line 5). Robida filed his petition for redetermination in the Tax Court (CT 1) December 26, 1962, in Frankfurt, Germany.

In determining underpayment and arriving at the amount of income claimed to have been fraudulently concealed, IRS relied on an arbitrary increase in net worth computation and on a bank withdrawal and deposit system to show non-deductible expenditures (CT 63). The notice of September 18, 1962 recites that the jeopardy assessment and income determination was made on the basis that Robida had failed to file returns for the years in question, and on a claimed absence of adequate records (CT 45, 48, 51, 54, 57, 60).

---

[1]Address on CT copy is not the same as original sent to Robida.

2. Commissioner Abandoned Fraud and Failure to File.

At the San Francisco hearing, October 5, 1964, Respondent IRS abandoned the issue of fraud for the first time (RT 3, line 12). At that time Respondent also abandoned its claim that Robida had not filed his returns for the years in question (RT 17, line 10).

3. Commissioner Had Robida's Records.

Robida did not have his records at the time of the San Francisco hearing (RT 17, line 10; 33, lines 14, 25; 34, line 12). They were in possession of Respondent.[2] His records were pertinent and important to his position and proof (RT 34, lines 11 to 22).

4. Robida's Records Were Pertinent and Important.

Among other things his records would show that disbursements from bank accounts which the IRS in their net-worth bank deposit and withdrawal computation methods relied on to prove living expenses, were actually merely transfers of money from one account to another (RT 35, line 11) or redeposits of the same money.

The Court asked Robida if he then had the bank accounts (RT 39, line 18). Robida replied that the Germans got them (RT 39, line 20). The Germans got them from the IRS (RT 34, lines 11-15).

A large part of the case turns on Robida's claim of exemption of earned income under Internal Revenue Code Section 911 as a resident of Germany (Tax Re-

---

[2]See Appendix B.

turns—CT 68, 74, 81, 86, 93, 98). Respondent knew he was such resident (RT 24, line 13), and while the IRS retained his records, the Court required him to prove his absence (RT 24, line 20).

5. Harassment.

In 1963, after the deficiency notice of September 18, 1962, Robida was imprisoned in Germany on false charges and was prevented from getting a hearing (RT 33, line 10). The charges were dropped (RT 57, lines 3, 17). Respondent knew of the false charges (RT 82, lines 6-18) and knew that Air Force Generals forced Robida to give a demonstration of his skill in manipulating slot machines (RT 62, lines 7-13).

During all of this time and up to the time of the hearing, Robida's records and other property were in possession of the Government and German officials acting in concert (RT 63, line 25, to 65, line 8; RT 88, lines 7-9). On May 13, 1966, after Notice of Appeal, Respondent sent copies of some of said records to John R. Swendsen, attorney for Mr. Robida. A copy of the forwarding letter is attached hereto as Appendix B.

Mr. Ciranni, counsel for IRS, shows that the Respondent knows that they have Robida's records and other property, as appears from the following questions by Mr. Ciranni and answers by Mr. Robida at page 64 of the reporter's transcript, at line 14, to page 65, line 8:

"Q. Did you get your property back?

A. No. I have got nothing back. I got a few papers from the American Consul, a few old newspapers and maps and letters.

Q. They are still holding your car?

A. That is correct.

Q. And your typewriter?

A. That's right.

Q. And $3500 in cash?

A. Well, I think you have the complete list of what they are holding.

Q. $911.00 of that was in nickels, dimes and quarters?

A. It is possible.

Q. Do you deny it?

A. I said it is possible.

Q. Which was taken from your possession?

A. It is quite possible, I didn't see them take it. They didn't give me the honor of allowing —permitting me to watch and search my car. Whatever they say, you have got the report. I won't dispute it."

The respondent also knew and had records of the falseness of the charges which resulted in Mr. Robida's incarceration in Germany, as appears from the following questions by the Court and answers by Mr. Robida at page 56 of the transcript, line 7 to page 57, line 5:

"The Court: Well, the Court doesn't know anything about that, Mr. Robida.

Is your question whether he was ever convicted involving moral turpitude?

Mr. Ciranni: Yes, your Honor.

By Mr. Ciranni:

Q. What was the result of these charges?

Mr. Ciranni: I know the answer.

The Court: Well, I don't.

Were you ever convicted of any charge, Mr. Robida? Would you be willing to tell the Court the nature of the conviction, if any, because I don't know? Do you have any reason to hide it? If so, I will listen to that.

The Witness: I am willing to go into that, too. I have nothing to be ashamed of, but on the other hand the respondent has considerable records of what took place.

They made a charge of larceny, true, and I objected to the charge and they knew it was false when they made it. The Americans knew it was false and the Germans knew it was false.

The Court: Were you ever convicted of it?

The Witness: The charge was dropped. There was a newspaper article that was written that was vicious. These charges——"

It is significant that the respondent did not attempt to refute or deny Mr. Robida's charges (see RT 81, line 17, to RT 82, line 18), but vilified him by the introduction of innuendoes of false charges.

See page 57 of the transcript, line 11, to page 58, line 15:

"By Mr. Ciranni:

Q. The specific question I asked is what was the result of these charges?

A. What charges?

Q. The charges on which you were arrested in Germany in July of '63?

A. They were false charges and they were dropped.

Q. Were not you deported from Germany?

A. I object to that because it is false. You are going, apparently, on the basis of a vicious and malicious newspaper article.

The Court: Were you deported?

The Witness: No, your Honor. This requires a hearing in a Court of Law to be deported. They refused to grant me a hearing against my rights in any respect. The law they were going on was a law during 1938 back in Hitler's days.

Most of those laws were repealed by the Occupation.

By Mr. Ciranni:

Q. You were expelled from the country but not deported?

A. It was not effective—for instance, I was not escorted outside of Germany. I was escorted to the train.

Q. You were expelled to Switzerland?

A. To any country I wanted to go. I was not limited as to which country. This was a law that was passed in 1938.

Q. You were expelled from Germany as a result of these charges?

A. No, I wasn't. If you want to know you should ask the Germans because they did this themselves. They are very particular about giving reasons as to why they do something. They were in conspiracy with the American Agents."

THE BURDEN OF PROOF WAS ON THE COMMISSIONER TO SHOW THAT THE DETERMINATION OF TAX LIABILITY WAS CORRECT.

1. Respondent Had Petitioner's Records.

There is a strong presumption that missing records, if produced, would be against the interest of those responsible for their loss. *Rosen v. U.S.,* 15 AFTR 501.

That presumption is as strong against the government as it is against the taxpayer, and perhaps stronger. *U.S. v. Heath,* 147 F. Supp. 877, 51 AFTR 630; (Affirmed 9th Cir., 1958 in 2 AFTR 5627, 260 F.2d 623.)

The principle of the *Heath* case is peculiarly applicable here. The government, having Mr. Robida's records and joining or appearing to join in false charges against him, resulting in unwarranted and unjust incarceration, charges him with fraud and failure to file returns, both charges susceptible to criminal action, assesses fraud penalties against him, seizes his money, and expects him to present a proper case on the non-fraud aspects of the case, while they retain his records.

2. The Commissioner Having Failed to Prove Fraud, Had the Burden of Pleading and Proving the Applicability of the Six Year Statute of Limitations.

The September 18, 1962, notice of determination of Tax and Assessment covered the years 1956 through 1961 (CT 43-62).

Internal Revenue Code Section 6501 provides that the amount of any tax imposed by this title shall

be assessed within three years after the return was filed.

Mr. Robida's returns for the years in question were filed as follows:

Year	Return Filed	Three Year Period Expired
1956	March 1957	March 1960 (CT 64)
1957	March 1958	March 1961 (CT 70)
1958	March 1959	March 1962 (CT 77)
1959	March 1960	March 1963 (CT 84)
1960	March 1961	March 1964 (CT 91)
1961	March 1962	March 1965 (CT 96)

Obviously, the statutory period of three years had run as to years 1956, 1957 and 1958.

Internal Revenue Code Section 6501(e) provides for a six year limitation period where the taxpayer omits from gross income an amount properly includable in excess of 25 per cent of the amount of gross income stated in the return. IRC Section 6501 (e)(iii) provides that in determining the amount omitted, there shall not be taken into account any amount disclosed in the return or in a statement attached to the return.

In claiming exemptions under IRC 911, Mr. Robida disclosed the sums which the Commissioner now seeks to disallow as exempt.

Where the Commissioner seeks to extend the statute of limitations, the burden of pleading and proof is on him. *C. A. Reis* (1942), 1 TC 9, 12; affirmed (CCA-6), 142 F.2d 900.

The Commissioner cannot meet this burden by merely introducing in evidence the notice of determi-

nation and assessment. See: *John Lima* (1952), 11 TCM 1114; *Marvin Berry* (1952), 11 TCM 301.

In the instant case the Commissioner produced no evidence other than his deficiency notice.

3. The Commissioner Abandoned His Formal Notice of Deficiency.

The September 18, 1962 Notice of Deficiency and Assessment was based on inadequacy of Robida's records, failure to file and fraud. At the hearing in the Tax Court, the Commissioner abandoned the claims of fraud and failure to file. Since the Commissioner had Robida's records and did not produce them, he also abandoned that ground. He therefore substantially abandoned all of the grounds of the assessment and deficiency notice and relied on different grounds.

Where the Commissioner relies on different legal grounds at the hearing, he is considered to have abandoned his deficiency notice. *Leon Papineow,* 28 TC 54; *Thomas Wilson,* 25 TC 1058; *Edmund Thomas Gulledge, Sr. v. Commissioner,* 249 F.2d 225, 52 AFTR 731.

When the Commissioner abandons a formal notice of deficiency, the burden is on him to prove his contentions. *Tex-Penn Oil Co. v. Commissioner* (3 Cir.) 83 F.2d 518.

THE COMMISSIONER'S NET WORTH CALCULATION IS NOT SUFFICIENT.

The Commissioner's net worth calculation (CT 63; 132) purports to be based on an opening net worth at December 31, 1955 of $57,292.77. Nowhere in that calculation does there appear an item of cash on hand. As appears from Mr. Ciranni's questioning of Mr. Robida (RT 64-65, supra), Mr. Robida might well have had appreciable amounts of cash on hand at any time. The net worth calculation does not take into account automobiles or other items of personal property.

A definite opening net worth must be established by the Government. *U.S. v. Eley,* 11 AFTR 2d 711.

The Commissioner, having Mr. Robida's records, certainly could have tracked down relevant leads that might have shown that Mr. Robida's net worth December 31, 1955, was in excess of the amount fastened upon.

It was incumbent on the Commissioner to do that. *Holland v. U.S.* (1954), 348 U.S. 121, 75 S.Ct. 127.

CONCLUSION

It is respectfully submitted that the Tax Court's decision was based upon a grossly unfair hearing. Mr. Robida, being charged with fraud and failure to file his returns; being subjected to imprisonment on false charges after the Commissioner made his jeopardy assessment; being subjected at the hearing before the Tax Court to a sudden switch in the rules; being

cross-examined as to scurrilous and unfounded imputations; being deprived of his records; could not possibly have presented a proper case for himself. No future trial could possibly be fair. Mere production of some, or even all, of his records at this late date, having been in hostile hands since 1962, would not put him in a position to defend himself against now admittedly false charges. He could not now rely on such records to sustain any burden of proof he might have on 'civil' or non-fraud matters.

It is respectfully urged that the Commissioner, having Mr. Robida's records and failing to produce them, had no proper entitlement to rely on a net worth calculation, nor on a bank withdrawal system, or any other system, to show tax liability on the part of Mr. Robida, other than reliance on Mr. Robida's records, without first showing that such records were inadequate.

The Commissioner having gone out of his way to throw the burden of proof on himself, failed to sustain it.

No rule or statute can or should operate to prevent this Honorable Court from doing substantial justice.

If Mr. Robida did not make a formal demand upon the Commissioner for production of his records, the transcript of the proceedings before the Tax Court is full of Mr. Robida's unheeded complaints that the Commissioner has his records. Under such circumstances, the principle announced in *U.S. v. Heath* (1958) (9th Cir.) 260 F.2d 623, at page 632, should apply.

"It is established principle that all the authority of Courts to do justice is not encompassed either by rules or statutes. Nor is the power of a Court to prevent injustice circumscribed by their language."

PRAYER

Wherefore, petitioner prays that the decision of the Tax Court be reversed and that the Commissioner be required to accept Mr. Robida's reports as filed for the affected years; that the Commissioner be ordered to return to Mr. Robida the monies seized by way of jeopardy assessment, plus interest; that costs of suit be awarded Petitioner, and that such further and other orders be made as shall seem to the Court to be meet and just.

Dated, San Francisco, California,
June 13, 1966.

JOHN R. SWENDSEN,
Attorney for Petitioner.

Certificate of Counsel

I certify that in connection with the preparation of this brief I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

John R. Swendsen,
Attorney for Petitioner.

(Appendices A and B Follow)

Appendices A and B

Appendix A

EXHIBITS OFFERED AND RECEIVED:

	For Identification	In Evidence
Respondent's Exhibit A	RT 40	RT 41
Respondent's Exhibits B through G	RT 41	RT 42
Respondent's Exhibit H	RT 42	RT 43
Petitioner's Exhibit No. 1	RT 68	RT 68
Petitioner's Exhibit No. 2	RT 77	RT 77

PETITIONER'S EXHIBITS OFFERED AND REFUSED:

	Offered	Refused
Letter from Morris Plan	RT 77	RT 78
Letter from William G. Binder	RT 79	RT 80
Letter from Senator Frank Kowalski	RT 79	RT 80
U.S. Government Employee records	RT 81	RT 82

APPENDIX B

UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the
Division Indicated
and Refer to Initials and Number

MR:LAJ:CRJust:kas
5-11504

May 13, 1966

AIR MAIL SPECIAL DELIVERY
RETURN RECEIPT REQUESTED

John R. Swendsen, Esq.
126 Post Street, Suite 600
San Francisco, California

Re: Daniel A. Robida v. Commissioner
(C.A. 9th - No. 20,592)

Dear Mr. Swendsen:

We are enclosing, for your information and for whatev
you deem desirable, copies of records turned over to the I
Revenue Service. As you know, they are not a part of the
in this appeal.

Sincerely yours,

RICHARD M. ROBERTS
Acting Assistant Attor
Tax Division

By: Lee A. Jackson

LEE A. JACKSON
Chief, Appellate Secti

Enclosure

No. 20,592

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DANIEL A. ROBIDA,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE

TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

MITCHELL ROGOVIN,
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Washington, D.C. 20530.

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IN THE UNITED STATES COURT OF APPEALS

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ON PETITION FOR REVIEW OF THE DECISION OF THE

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (I-R. 129-141) 1/ are not officially reported.

JURISDICTION

This petition for review involves deficiencies in federal income taxes for the years 1956 through 1961, totaling $46,559.55. (R. 4.) The taxpayer filed income tax returns for the taxable years with the District Director of Internal Revenue in Portsmouth, New Hampshire. (Exs. B through G; I-R. 64-104, 130.) On September 18, 1962, the Commissioner mailed a notice of deficiency showing deficiencies in income tax for the six years

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1/ "I-R." and "II-R." references are to Volumes I and II of the record on appeal.

in the total amount of $46,559.55, plus additions to tax totaling $24,583.45 (I-R. 43.) Within 150 days thereafter, 3/ and on December 24, 1962, the taxpayer filed a petition with the Tax Court for a redetermination of the deficiencies, under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-3.) The decision of the Tax Court was entered July 30, 1965. (I-R. 182-183.) The case is brought to this Court by a petition for review filed by the taxpayer on August 25, 1965, within the 3-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. (I-R. 184.) Jurisdiction is conferred on this Court by Section 7482 of that Code. The parties stipulated as to the venue of this Court. (I-R. 192.)

QUESTIONS PRESENTED

1. Did the Tax Court err in determining that the taxpayer failed to report the full amount of his taxable income in each of the years 1956 through 1961?

2. Did the Tax Court err in holding that no portion of the taxpayer's income in the taxable years was exempt from federal taxation under the provisions of Section 911 of the Internal Revenue Code of 1954?

2/ Of this amount, the Commissioner conceded $23,209.79 in fraud penalties in the Tax Court. (II-R. 3.)

3/ Apparently duplicate copies of the notice of deficiency were addressed to the taxpayer at his last known address in California and to him in Germany. (I-R. 4, 43.) Since he was outside the United States when he filed his petition (I-R. 3), a 150-day period applied from the date of the notice of deficiency within which to file a petition to the Tax Court, under Section 6213(a) of the Internal Revenue Code of 1954, as stated in the notice.

3. Is the taxpayer precluded from raising the issue of the statute of limitations on appeal where he did not raise it below; and in any event, would the statute of limitations be inapplicable to bar five of the six taxable years?

4. Did the Tax Court correctly decline to consider the requested abatement of the jeopardy assessment against the taxpayer?

5. Did the Tax Court err in determining that the taxpayer is liable for additions to tax under Code Section 6654 for each of the taxable years for failure to pay any estimated income tax?

STATUTES AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and other authorities are set out in Appendix A, infra.

STATEMENT

The facts as found by the Tax Court (I-R. 129-134) may be summarized as follows:

The following schedule reflects the taxable income and income tax liability reported by the taxpayer on his returns (I-R. 130):

Year	Taxable Income	Tax Liability
1956	$ 889.00	$ 142.24
1957	703.00	112.48
1958	2,162.00	349.62
1959	3,592.37	606.80
1960	4,849.30	886.35
1961	6,255.82	1,262.11
Totals	$18,451.52	$3,359.60

He paid in full the income tax liabilities reported on his returns. (I-R. 130.)

The following schedule reflects the amount of income reported by the taxpayer on his returns as tax exempt under the provisions of Section 911 of the Internal Revenue Code of 1954 (I-R. 131): 4/

Year	Income Reported as Tax Exempt
1956	$ 1,900.00
1957	1,900.00
1958	9,000.00
1959	19,500.00
1960	19,900.00
1961	24,987.00
Total	$77,187.00

This allegedly tax exempt income was reported by the taxpayer on his returns as having been earned income abroad as a sales promoter and instructo in the operation of machines under the terms of an employment agreement with Service Games Ltd. of Gotenda, Tokyo. On the return for 1961, the taxpayer's services under the agreement were described as "repairs of machines by soliciting, teaching and practicing the diagnosing and the manipulating of machines." Service Games Ltd. was a manufacturer of slot machines. The taxpayer never received any income for services or for any other reason from Service Games Ltd. of Gotenda, Tokyo, in the taxable years. (I-R. 131.)

The Commissioner computed the deficiencies herein by the net worth plus nondeductible expenditure method (I-R. 131) as follows (I-R. 132):

4/ In statements attached to the 1960 and 1961 returns the taxpayer stated he should have listed $13,400 instead of $9,000 in 1958 and $21,952 instead of $19,900 in 1960. (I-R. 93, 98, 131.)

	Account No.	Year Ended Dec. 31, 1955	Year Ended Dec. 31, 1956	Year Ended Dec. 31, 1957	Year Ended Dec. 31, 1958	Year Ended Dec. 31, 1959	Year Ended Dec. 31, 1960	Year Ended Dec. 31, 1961
ASSETS:								
Cash								
Rochester Trust Co., Rochester, New Hampshire	56305	$ 11.24	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Industrial City Bank, Worcester, Massachusetts	3235	1,128.01	0.00	0.00	0.00	0.00	0.00	0.00
Morthrift Plan, Sacramento, California	1164	7,390.54	10,136.89	4,912.63	6,468.93	13,566.38	14,107.55	23,444.26
Guardian Thrift and Loan San Francisco, California	249	7,019.60	1,271.75	1,650.48	1,734.06	15,191.89	9,580.18	10,065.22
Schwabacher & Co. San Francisco, California	77193	1,389.04	520.40	(5,308.87)	646.34	(3,823.67)	1,549.81	352.92
Fireside Thrift, San Francisco	3123	0.00	6,060.00	6,304.82	6,559.50	6,824.48	7,136.79	7,463.40
West Coast Savings, Sacramento	7222	0.00	0.00	0.00	0.00	0.00	4,045.75	4,229.92
Morthrift Plan, Stockton, Calif.	5573	0.00	0.00	0.00		0.00	21,802.98	22,239.02
Total Cash		$16,938.43	$17,989.04	$ 7,559.06	$15,408.83	$31,759.08	$58,223.06	$67,794.74
Stock								
Cost of Stock acquired:		$40,354.34	$40,354.34	$40,354.34	$40,354.34	$40,354.34	$40,354.34	$40,354.34
1956			2,617.47	2,617.47	2,617.47	2,617.47	2,617.47	2,617.47
1957				13,932.30	13,932.30	13,932.30	13,932.30	13,932.30
1958					1,217.00	1,217.00	1,217.00	1,217.00
1959						5,044.00	5,044.00	5,044.00
1960							220.00	220.00
1961								9,937.00
TOTAL ASSETS		$57,292.77	$60,960.85	$64,463.17	$73,529.94	$94,924.19	$121,608.17	$141,116.8
LIABILITIES:	NONE							
NET WORTH:		$57,292.77	$60,960.85	$64,463.17	$73,529.94	$94,924.19	$121,608.17	$141,116.8
INCREASE IN NET WORTH:			$ 3,668.08	$ 3,502.32	$ 9,066.77	$21,394.25	$ 26,683.98	$ 19,508.6
NONDEDUCTIBLE DISBURSEMENTS:								
Schwabacher & Co., San Francisco, Calif.			$ 5.00	$ 5,103.37	$ 332.91	$ 32.72	$ 12.23	$ 18.2
Morthrift Plan, Sacramento, Calif.			$10,910.00	$ 978.00	$ 0.00	$ 0.00	$ 500.00	$ 50.0
Guardian Thrift and Loan, San Francisco, Calif.			$ 2,245.04	$ 100.00	$ 0.00	$ 0.00	$ 0.00	$ 0.0
Personal Living Expenses			$ 5,000.00	$ 5,000.00	$ 5,000.00	$ 5,000.00	$ 5,000.00	$ 5,000.0
ADJUSTED GROSS INCOME			$21,828.12	$14,683.69	$14,399.68	$26,426.97	$ 32,196.21	$ 24,576.9

The taxpayer introduced no evidence in the Tax Court which would show any error in the Commissioner's net worth computation. (I-R. 133.)

The taxpayer was physically present in the United States from August 1956 to July of 1957. At all other times throughout the years 1956 to 1961, inclusive, he was traveling in Japan, Okinawa, Formosa, Manila, France, Belgium, Germany, Spain, Morocco and Switzerland. While thus traveling, he did not intend to make his home abroad. He lived in hotels and ate in restaurants. He "felt that the cost of living and travel over there was rightfully attributable to my income and deductable from the income that I reported * * *." During this time he visited some 500 military service clubs abroad. In 1959, 1960 and 1961 he paid Miss Inge Muench, who was born and raised in Germany, some $6,000 "for going to clubs with him." At the time she was under twenty-one years of age and most of the time she spent with the taxpayer was in Wiesbaden, Germany. (I-R. 133.)

In some unexplained way the taxpayer claims that he learned through contacts with employees of Service Games Ltd. of Gotenda, Tokyo, how to "manipulate" the slot machines they manufactured so that he was able to receive income from such "manipulation". This "manipulation" was either done by himself in the service clubs he visited or by servicemen who were club members and whom he was "teaching how to diagnose these machines as well as manipulate" them. When the servicemen whom he was "teaching" to "manipulate" the machines themselves played the machines, they did so under an arrangement with the taxpayer that when they collected a jackp it was divided with the taxpayer. The percentage of the division between the taxpayer and the soldier-player varied. If no jackpot was collected, the taxpayer received no payment. (I-R. 133-134.)

The taxpayer engaged in forms of gambling other than playing slot machines, while traveling abroad during the years in question, for substantial sums of money. Whether he won or lost is not established by the evidence. (I-R. 134.)

The evidence does not show that the taxpayer received any wages, salaries or professional fees or other amounts as compensation for personal services actually rendered during the years in question from sources without the United States. (I-R. 134.) In the absence of any evidence to the contrary, the Tax Court (1) sustained the Commissioner's determinations of deficiencies in the years 1956 through 1961; (2) held that the taxpayer had failed to show that any of his income was tax exempt under Section 911 of the Internal Revenue Code of 1954 as earned income received from sources without the United States from wages, salary, professional fees, or as compensation for personal services actually rendered; and (3) sustained the imposition of additions to tax under Code Section 6654 for failure to pay any estimated income tax in the taxable years. (I-R. 134-141.) The taxpayer has petitioned this Court to review the decision of the Tax Court. (I-R. 184.)

SUMMARY OF ARGUMENT

1. The Tax Court found that the Commissioner's determination of deficiencies in income tax for each of the years 1956 through 1961 by use of the net worth plus non-deductible expenditures method of reconstructing income was correct. This finding was based on substantial evidence and has not been shown to be clearly erroneous. The Tax Court's decision was based on an examination of all the record facts and should not be overturned unless clearly erroneous under established standards of review. This Court

has consistently approved of the net worth method as used here by the Commissioner to reconstruct the taxpayer's income. The Commissioner is justified in using the net worth method where a taxpayer's records are non-existent or where they are considered incomplete, inaccurate, or in some manner unsatisfactory. The Tax Court found that the taxpayer produce no records or documentary evidence at all of any materiality to the issues

The Commissioner was not responsible for the loss of any of the taxpayer's records, and he made photostats of the taxpayer's records in the Internal Revenue Service files available to the taxpayer before the hearing in the Tax Court. He has since given taxpayer's counsel a copy of these photostats and has offered to stipulate to have the case remanded so that the taxpayer could introduce and testify concerning whatever porti of the photostats of these records he might believe to be relevant to his case. The Commissioner made no use of these photostats in computing the net worth statement attached to the notice of deficiency, nor could he have done so since the photostats were necessarily obtained after the taxpayer's records were seized by the German police, which was admittedly a considerable time after the notice of deficiency was mailed. In any event these photstats are not before this Court, and in the light of the taxpayer's failure to produce any other evidence, of his refusal to make use of them in the Tax Court, and of his opposition to remand, we must assume that they would have been of no assistance to him in disprovin the deficiencies. As the Tax Court stated, "what they would have shown, had they been available, is nebulous."

The taxpayer did not dispute the Commissioner's net worth computation in the Tax Court, and there admitted that it was substantially correct.

He presented no evidence that any disbursements he disputed were in fact transferred to other accounts, and the Revenue Agent who examined the taxpayer's bank accounts testified that the two disputed disbursements in 1956 could not possibly have been redeposited in any of the taxpayer's other accounts. Furthermore, the taxpayer failed to disprove that the Commissioner's allowance of $5,000 per year for living expenses was at all unreasonable. The evidence shows that in addition to the $1,200 per year which the taxpayer estimated his living expenses to be, he spent large sums for traveling continuously from country to country, for lodging in hotels, for meals in restaurants, and he made payments totalling $6,000 during 3 of the years to a young German girl for accompanying him to clubs. None of these items is deductible. In view of the taxpayer's testimony that he did not intend to establish a home abroad and that he was in a continuous travel status during the years in issue, he is not entitled to deduct any away-from-home travel expenses. It is fair to infer that his admitted expenditures for travel, hotel, meals, and payments to the young German girl, would raise his estimate of his living expenses to at least $5,000 per year. There is no merit to the contention that the Commissioner's opening net worth in 1956 failed to take into consideration certain money and property. The taxpayer did not raise this issue in his petition in the Tax Court, and stipulated to the exact figure used by the Commissioner as the opening net worth in 1956, when he settled prior tax years on a net worth basis ending with 1955. He is precluded now from contending that opening net worth shall be clearly and accurately established by competent evidence. The taxpayer's failure to offer credible explanations of his net worth increases is obviously relevant and material. It is not

incumbent on the Commissioner to disprove all possible sources of non-taxable income, only those actually claimed by the taxpayer.

2. The Tax Court correctly held that no part of the income derived by the taxpayer in each of the years 1956 through 1961 was exempt from taxation under the provisions of Section 911 of the Internal Revenue Code of 1954. As the Tax Court pointed out, inasmuch as the taxpayer failed to introduce any evidence regarding the amount of "earned income" he allegedly derived from foreign countries in each of the years at issue he is not entitled to any exemption under Section 911, even if it were assumed, arguendo only, that slot machine income could be "earned income."

The taxpayer was not a bona fide resident of any foreign country since he did not maintain a real home where he assumed the obligations of a foreign country, and participated in its life and community activities. He admitted at the trial that he did not intend to establish a home in any European country, and also that he had denied to the German authorities that he was a resident of Germany for German income tax purposes.

In any event, income derived abroad from slot machines and cards would not constitute "earned income" entitled to exemption under the provisions of Code Section 911. This section defines earned income as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered." The Code recognizes that slot machines are gaming devices. The Commissioner has ruled that gambling income does not constitute "earned income" within the meaning of the statute. There is ample evidence in the record to show that the taxpayer manipulated the slot machines himself. With respect to his contention that he was teaching others how to manipulate them, he could not cite a single instance or name a single person from whom he received

compensation. The Tax Court who heard his testimony did not believe his testimony in this respect. The Commissioner's restrictive interpretation of "earned income" is proper and correct in view of the general purposes of Section 911, which was designed to be a relief provisions to ease the burden imposed on United States citizens by Code Section 61. The special exemption in Section 911 should be strictly construed under the well-established rule of statutory construction that provisions granting relief or special exemption from income taxes are to be strictly construed. Exclusions from gross income are a matter of legislative grace and the burden of showing the right thereto is on the taxpayer. The taxpayer here has failed to show any such right.

3. The taxpayer is precluded from raising the matter of the statute of limitations inasmuch as he did not raise the issue in the Tax Court. Here, for the first time, he seeks to raise the issue for the first three taxable years (1956 through 1958). He has not attempted to raise this issue with respect to 1959 through 1961, nor could he do so, since the notice of deficiency was mailed within the usual three year statutory period provided in Section 6501(a) of the 1954 Code. The general rule is that questions not raised in the trial courts may not be considered in the appellate courts. No reason has been advanced here for making any exception, and it is submitted that the facts of the instant case do not warrant doing so. It has frequently been held that the defense of the statute of limitations may not be raised for the first time in the Court of Appeals when not pleaded in the Tax Court. No exceptional circumstances exist here which would warrant any different holding.

Moreover, the assessment of the deficiencies asserted against the taxpayer would not be barred for five of the six taxable years, even if

the taxpayer had raised the issue below. Section 6501(e)(1) provides that if a taxpayer omits an amount in excess of 25 percent of his gross income as stated in the return, the tax may be assessed at any time within six years after the return was filed. As to 1956 and 1957, the taxpayer clearly omitted more than 25 percent of the amounts he disclosed on his returns, even including the sums he contended were tax exempt under Section 911 of the Code. As to 1958, the asserted deficiency also exceeds the total amount disclosed, but not by 25 percent. However, inasmuch as the taxpayer failed to raise the issue of the statute of limitations in the Tax Court, he is precluded from doing so for the year 1958, as well as for all other years, for the first time at this stage of the proceedings. In the event that this Court should decide to remand the case to the Tax Court, the Commissioner would have no objection to this Court entering an order directing the Tax Court to permit the taxpayer to amend his petition so as to raise the issue of the statute of limitation as to 1958.

4. The Tax Court correctly declined to consider the requested abatement of the jeopardy assessment against the taxpayer. The jeopardy assessment was made prior to the issuance of a notice of deficiency, and the Commissioner duly issued his notice of deficiency within sixty days as required by Section 6861(b) of the 1954 Code. The Tax Court correctly stated that it had no authority to consider the jeopardy assessment or to abate it. The Commissioner is authorized to make a jeopardy assessment u Section 6861(a) of the Code, and the making of such an assessment is a di cretionary prerogative which the District Director may make whenever he believes that collection of the tax will be jeopardized by delay. The

courts have declined to inquire into his belief or in any way substitute their judgment for his. The taxpayer's institution of proceedings in the Tax Court and his appeal to this Court in no way operate to stay the Commissioner's hand from enforcing the jeopardy assessment in the absence of a bond. Prior to the Tax Court's decision, the taxpayer could have filed an application for abatement under Section 6861(g) with the District Director, fully stating the reasons why he believed jeopardy does not exist, and giving supporting evidence. The Tax Court had jurisdiction to determine overpayments during the taxable years, and under Section 6861(f) of the Code at the conclusion of these proceedings, if the amount already collected exceeds the amount determined as the amount which should have been assessed, the excess will be credited or refunded to the taxpayer, without the necessity of filing a claim therefor. This Court, however, should deny the taxpayer's request to consider the jeopardy assessment, and should decline to order the Commissioner to return the money seized.

5. The Tax Court correctly sustained the Commissioner's additions to tax under Section 6654 of the Code for the taxpayer's failure to file declarations of estimated tax for the years 1956 through 1961. Although he was required to file declarations of estimated tax by Section 6015 of the Code, the taxpayer filed no declarations during any of the taxable years, and at the trial made no explanation of why he did not file them. The Tax Court necessarily sustained the Commissioner's determination of liability. The imposition of the additions to tax for failure to file declarations has frequently been sustained by the courts. It is submitted that the Tax Court correctly affirmed their imposition against the taxpayer.

ARGUMENT

I

THE TAX COURT FOUND THAT THE COMMISSIONER'S DETERMINATION OF DEFICIENCIES IN INCOME TAX FOR EACH OF THE YEARS 1956 THROUGH 1961 BY USE OF THE NET WORTH PLUS NON-DEDUCTIBLE EXPENDITURES METHOD OF RECONSTRUCTING INCOME WAS CORRECT AND THIS FINDING WAS BASED ON SUBSTANTIAL EVIDENCE AND HAS NOT BEEN SHOWN TO BE CLEARLY ERRONEOUS

The principal issue in this appeal is whether there is substantial evidence to support the deficiencies in income tax of the taxpayer as found by the Tax Court for each of the years 1956 through 1961. The Commissioner utilized the net worth plus non-deductible expenditures method in determining that the taxpayer had deficiencies in income tax for the years 1956 through 1961. (I-R. 43-63.) The Tax Court, after examining the record, which consisted of testimony and exhibits, upheld the Commissioner's determinations. (I-R. 129-141.) The Commissioner submits that the Tax Court decision was based on an examination of all the record facts and should not be overturned unless clearly erroneous under established standards of review. Commissioner v. Duberstein, 363 U.S. 278, rehearing denied, 364 U.S. 925; United States v. Gypsum Co., 333 U.S. 364, 395; Baumgardner v. Commissioner, 251 F. 2d 311 (C.A. 9th); Rule 52(a), Federal Rules of Civil Procedure; Section 7482 of the Internal Revenue Code of 1954.

This Court has consistently approved of the net worth method as used here by the Commissioner to reconstruct the taxpayer's income. 5/

5/ Among the cases in which this Court has approved the use of the net worth method are the following: Heider v. United States, 347 F. 2d 695; Baumgardner v. Commissioner, supra; Showell v. Commissioner, 238 F. 2d 148; Sterns v. Commissioner, 235 F. 2d 584; Gobins v. Commissioner, 217 F. 2d 952 Rose v. Commissioner, 188 F. 2d 355, certiorari denied, 342 U.S. 850; Estate of Gaviati v. Commissioner, 127 F. 2d 861.

The Commissioner is justified in using the net worth method where a taxpayer's records are non-existent or where they are considered incomplete, inaccurate, or in some manner unsatisfactory. United States v. Johnson, 319 U.S. 503, rehearing denied, 320 U.S. 808; Bryan v. Commissioner, 209 F. 2d 822 (C.A. 5th), certiorari denied, 348 U.S. 912. Here the Tax Court found that the taxpayer produced no records or documentary evidence at all of any materiality to the issues. 6/ The Tax Court leniently had allowed the taxpayer to testify at length, even concerning issues he had not raised in his petition, probably because he was not represented by counsel.

6/ The taxpayer's brief attempts to make the Commissioner responsible for the fact that the taxpayer did not have certain records at the time of the Tax Court hearing. (Br. 3.) In the Tax Court, the taxpayer stated (II-R. 39, 57-58, 63, 82) that the Germans seized his records in July 1963 (I-R. 41) at the time he was arrested in Germany in connection with charges unrelated to the instant case, and expelled from the country in November 1963 (I-R. 111). Now he falsely states that the Germans got his records from the Internal Revenue Service. (Br. 3.) The record citation given fails to support any such accusation. Documents attached to the Commissioner's answer to the taxpayer's Motion in Opposition to Motion to Remand and Motion for Final Judgment, Appendix B, infra, forwarded to this Court August 22, 1966, clearly show that the only material of the taxpayer in the possession of the Internal Revenue Service at the time of the trial in the Tax Court was in the form of photostats of certain documents obtained by the Office of International Operations from the German police, and that the originals of such documents were held by the German police until they were borrowed by the Office of International Operations in May 1966. The affidavit of Mr. Ciranni, who tried the case in the Tax Court, states clearly, Appendix B, infra, that the taxpayer was permitted to inspect the photostats of the five notebooks on three occasions; and that the taxpayer was advised that he could examine them whenever he wished and could rely on them in any manner, but that the Commissioner could not introduce the photostats into evidence because they were not properly authenticated and the taxpayer would not stipulate as to their accuracy. The taxpayer did not choose to make a formal demand on the Commissioner for these photostats. (Br. 12.)

The Commissioner did not use any of the photostats of the taxpayer's records held by the German police in computing the net worth statement attached to his notice of deficiency, and could not have done so since the notice is dated September 18, 1962 (I-R. 43) and the seizure of the taxpayer's records by the German police was not until July 1963 (I-R. 41); and whatever copies of the records which are in the Internal Revenue Service files necessarily were obtained subsequent to such seizure.

(continued on following page)

The taxpayer did not dispute the amount of the Commissioner's net worth computation in his petition (I-R. 1-3) as the Tax Court pointed out (I-R. 135), and, in fact, at the Tax Court hearing admitted that the computation was substantially correct (II-R. 39). The taxpayer's brief falsely accuses the Commissioner of wrong-doing and harrassment in connection with matters totally unrelated to the instant case (Br. 2-13), argues at length concerning an issue no longer in the case 7/ (Br. 3, 8-11) and erroneously seeks to shift the burden of proof to the Commissioner (Br. 8-10). He contends (Br. 3-4) that his records would show disbursements from bank accounts, that the Commissioner allegedly relied on them to prove living expenses, but that these disbursements were actually merel transfers of money from one account to another or redeposits of the same

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6/ (continued from preceding page)

In the interest of fairness, since the taxpayer was not represented by counsel in the Tax Court, on May 13, 1966, counsel for the Commissione furnished the taxpayer's counsel with a xeroxed copy of the photostats of the taxpayer's five diaries which had been transmitted with the Internal Revenue Service files in this case, and offered to stipulate with the taxpayer's counsel that the case be remanded so that he might offer into evidence and testify concerning such portions, or all, of the copies of the diaries which he believes may be relevant to his case. As this Court knows, the taxpayer refused to so stipulate, and opposed the Commissioner' Motion to Remand the Case to the Tax Court for this purpose.

For the convenience of the Court, the Commissioner's Motion to Remand and his Answer to the taxpayer's Motion in Opposition to Motion to Remand and Motion for Final Judgment, with supporting affidavit, are reproduced in Appendix B, <u>infra.</u>

7/ As indicated in fn. 2, <u>supra</u>, the Commissioner conceded fraud penalties in the Tax Court (II-R. 3), but the brief of the taxpayer continues to discuss fraud in his brief filed in this Court.

money. There is no merit to these contentions. It is submitted that the taxpayer had full opportunity to use whatever copies of his records the Internal Revenue Service files contained (see fn. 6, supra), and that there is nothing in the record to make the Commissioner responsible in any way for the taxpayer's loss of his records, as falsely alleged. (Br. 8.) Since the taxpayer inconsistently now contends he cannot rely on the copies of his records furnished to him (see fn. 6, supra), we must assume that whatever records he kept would not have been of assistance to him in disproving the deficiencies. As the Tax Court stated (I-R. 136), "what they would have shown, had they been available, is nebulous."

As the Tax Court indicated during the trial (II-R. 39), the taxpayer disputed only 3 items in the Commissioner's net worth statement: namely, the $5,000 per year living expense item, and the non-deductible disbursements in 1956 of $10,910 and $2,245.04 (I-R. 63). In fact, the taxpayer admitted at the trial (II-R. 39) that he did not "see any reason to dispute" the other items in the Commissioner's net worth statement. Naturally, since all the items are based on records of banks and other financial institutions located in the United States, which the taxpayer could easily inspect, it is obvious that he could have no reason to dispute the other items. He failed to present specific evidence that any disbursements were, in fact, transferred to other accounts, whereas Revenue Agent Shamberger testified (II-R. 102-104) that his examination of the taxpayer's various bank accounts established that the two disputed disbursements in 1956 could not possibly have been redeposited in any of the taxpayer's other accounts. Although no evidence was presented as to how these disbursements were expended by the taxpayer, it is probable that he used the money to pay his living expenses during the period he was in the

the United States and from the United States to Germany. He may also have used a large part of it to finance his activities in Germany after he arrived there in 1957.

With respect to the $5,000 per year used by the Commissioner to represent the taxpayer's living expenses, it is clear that the taxpayer spent sums substantially in excess of that amount every year for personal, non-deductible purposes. The only direct testimony concerning the taxpayer's cost of living consisted in his self-serving testimony to the effect that he spent only $1,200 per year as living expenses. His estimate, however, admittedly did not include amounts he paid for personal expenses such as food and lodging, which he erroneously considered to be deductible items. (II-R. 45-47.) His testimony concerning amounts he deducted for such items is vague at best. Furthermore, he testified (II-R. 45) that he did not include in his estimate the cost of traveling continuously from country to country, which he likewise deducted before reporting any income to the Government. He traveled continuously in the taxable years between more than 500 military installations in Germany, Belgium, France, Spain, Morocco, Japan, Okinawa, Formosa, and Manila. (II-R. 35-37, 45-47.)

In addition, Miss Inge Muench testified (II-R. 85) that the taxpayer gave her $6,000 between 1959 and 1961 for going to clubs with him. Neither this amount nor any similar sums he might have spent in the taxable years 1956 through 1958 were included in the taxpayer's estimate of his living expenses. In view of the taxpayer's testimony that he has no home in the United States (II-R. 44) and that he did not intend to establish one in Europe (II-R. 35), he was in a continuous travel status during the years at issue and is not entitled to deduct any "away from home" travel expenses. United States v. Mathews, 332 F. 2d 91 (C.A. 9th); James v. United States,

308 F. 2d 204 (C.A. 9th); Fisher v. Commissioner, 230 F. 2d 79 (C.A. 7th). The Commissioner's determinations of the estimated living expenses are presumptively correct, and the taxpayer has the burden of showing them incorrect. Welch v. Helvering, 290 U.S. 111, 115; Zeddies v. Commissioner, 264 F. 2d 120, 126 (C.A. 7th), certiorari denied, 360 U.S. 910, rehearing denied, 361 U.S. 855. After careful consideration of the record, the Tax Court reasonably sustained the Commissioner's determination that the taxpayer's living expenses were at least $5,000 a year. The Tax Court's findings, being based on the record evidence, were entirely reasonable. Millikin v. Commissioner, 298 F. 2d 830 (C.A. 4th). It was not bound to believe or accept the testimony of the taxpayer, particularly in view of his self interest. Mendelson v. Commissioner, 305 F. 2d 519 (C.A. 7th), certiorari denied, 371 U.S. 877; Banks v. Commissioner, 322 F. 2d 530 (C.A. 8th), certiorari denied, 350 U.S. 986; Burka v. Commissioner, 179 F. 2d 483 (C.A. 4th). It is fair to infer that the taxpayer's admitted expenditures for travel, hotels and meals, as well as for Miss Muench's payments, none of which he included in his $1,200 per year estimate for living expenses, would raise this amount to at least $5,000 per year.

The taxpayer here contends (Br. 11) that the Commissioner's opening net worth failed to take into consideration cash on hand, automobiles, and personal property. The taxpayer did not raise this point in his petition in the Tax Court, and only vaguely referred to it at the trial in the Tax Court. (II-R. 74-75.) The approval by the Tax Court of the Commissioner's determination of opening net worth was a determination of fact which has not been shown to be clearly erroneous and should be sustained. Halle v. Commissioner, 175 F. 2d 500, 503 (C.A. 2d), certiorari denied, 338 U.S. 949. Moreover, there is no evidence in the record warranting an allowance of undeposited cash. Furthermore, the taxpayer stipulated to $57,292.77

used by the Commissioner as the opening net worth in 1956. As the record shows and the taxpayer admits (II-R. 68, 73-74; I-R. 36, 177), the taxpayer's liabilities for prior taxable years (1949-1955) were settled on a net worth basis in 1957. Mr. Lee, who represented the Internal Revenue Service in that settlement, testified (II-R. 74-75) that the taxpayer had never contended in that prior settlement that there should be an allowance for cash on hand in the closing net worth. As Mr. Cirrani, the attorney who tried the instant case in the Tax Court, explained to the court (II-R. 12), and as the taxpayer admits (II-R. 73-74), the opening net worth for 1956 in the Commissioner's statement of deficiency for the instant taxable years ($57,292.77, I-R. 132) was based on the closing net worth for 1955 in the prior case where the same sum was stipulated. The taxpayer is precluded now from contending that what he agreed to as his closing net worth in 1955 was not the opening net worth for 1956, the first of the instant taxable years. An opening net worth stipulated by the parties clearly satisfies the requirement that an opening net worth shall be clearly and accurately established by competent evidence. Cefalu v. Commissioner, 276 F. 2d 122 (C.A. 5th); Shaw v. Commissioner, 252 F. 2d 681 (C.A. 6th); United States v. Fenwick, 177 F. 2d 488 (C.A. 7th).

The taxpayer's failure to offer credible explanations of his net worth increases is obviously relevant and material. The Government's burden is to present "effective negations of reasonable explanations by the taxpayer inconsistent with guilt" and to "track down relevant leads furnished by the taxpayer." Holland v. United States, 348 U.S. 121, 135, rehearing denied, 348 U.S. 932. It is not incumbent on the Commissioner to disprove all possible sources of nontaxable income, only those actually

claimed by the taxpayer. United States v. Massei, 355 U.S. 595; Ferris v. Commissioner, 317 F. 2d 333 (C.A. 2d); Gatling v. Commissioner, 286 F. 2d 139, 144-145 (C.A. 4th); Commissioner v. Thomas, 261 F. 2d 643, 646 (C.A. 1st).

II

THE TAX COURT CORRECTLY HELD THAT NO PART OF THE INCOME DERIVED BY THE TAXPAYER IN EACH OF THE YEARS 1956 THROUGH 1961 WAS EXEMPT FROM TAXATION UNDER THE PROVISIONS OF SECTION 911 OF THE INTERNAL REVENUE CODE OF 1954

The taxpayer contends that a large portion of the deficiency is income earned abroad when he was allegedly a resident of Germany and that such income was tax exempt under Section 911 of the Internal Revenue Code of 1954, Appendix A, infra. (Br. 3.) The Tax Court held (I-R. 136-140) that the record fails to show that any of the taxpayer's income was tax exempt, because the taxpayer had failed to show how much of his income was allegedly exempt under Section 911 of the 1954 Code and also that any of the income he derived abroad was "earned income" entitled to any tax exemption under that section of the Code. It is submitted that the Tax Court's findings were entirely correct.

As the Tax Court pointed out (I-R. 137), the taxpayer's testimony adds up to arguing that some amounts of his income received were allegedly earned as personal services actually rendered, but there is no evidence in the record which permitted the Tax Court even to guess how much money was so claimed. Even if it were assumed, arguendo only, that slot machine income derived abroad is exempt from taxation under the provisions of Section 911, the taxpayer obviously is not entitled to any exemption unless he first establishes exactly how much income he allegedly derived from that source in each of the years at issue. Inasmuch as he failed to introduce any

evidence regarding the amount of this income, he is not entitled to any exemption under Section 911. Section 911(a)(1) of the 1954 Code provides that an individual citizen of the United States may exclude from his gross income amounts up to $20,000 received from sources outside the United States are exempt from taxation if he establishes to the satisfaction of the Secretary of the Treasury that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which include an entire taxable year. The legislative history of Section 911 indicates that since 1942 this section has not been intended to benefit all persons with respect to income derived outside the United States, but only a bona fide resident of a foreign country or countries. See Section 148 of the Revenue Act of 1942, c. 619, 56 Stat. 798; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 54, 116 (1942-2 Cum. Bull. 504, 505, 591); H. Confere Rep. No. 2586, 77th Cong., 2d Sess., p. 44 (1942-2 Cum. Bull. 701, 708); Downs v. Commissioner, 166 F. 2d 504, 508 (C.A. 9th), certiorari denied, 334 U.S. 832, rehearing denied, 335 U.S. 837. As used in the legislative history, "bona fide residence" means a maintenance of a real home establis ment by a person who is physically present in a foreign country over a period of years and who assumes the obligations of such home, including the payment of taxes, and participation in the life and activities of the community. The taxpayer testified that during the taxable years he was continuously traveling between military installations in some ten countrie (II-R. 35-37, 45-47), and that he did not intend to establish a home in an of them (II-R. 35). He now contends (Br. 3) that he was a resident of Germany. Although he may have been physically present longer in Germany than in any other of the countries he visited, he admittedly denied to the German authorities that he was a resident of Germany for German income

tax purposes. (II-R. 62, 63.) 8/ Furthermore, he lived in hotels, ate in restaurants, maintained no permanent address (II-R. 35-37), and deposited all his income in financial institutions located in the United States (I-R. 63

It is submitted that the taxpayer's income from slot machines and cards derived abroad in any case would not constitute "earned income" entitled to exemption under the provisions of Section 911 of the 1954 Code. Section 911(b) of the 1954 Code defines "earned income" as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered." There were misleading statements on the taxpayer's returns indicating that income was from a manufacturer of slot machines in Japan. In 1956, he attached a statement to his return (I-R. 68) stating that $1,900 was exempt under Section 911 "which was earned as a result of labor performed while a resident of Japan from October 18, 1954 to August 1, 1956." On his 1957 return, he stated (I-R. 71, 74) that he received $1,900 tax exempt foreign income which he had earned "as sales promoter and instructor in the operation of machines, as under the terms of employment agreement with Service Games Ltd. of Gotenda, Tokyo." In 1958 and 1959 his returns stated (I-R. 81, 86) he had earned $9,000 and $19,000 respectively while "Employed as sales promoter, solicitor and instructor and teaching operation of machines etc. as under terms of agreement with Service Games Ltd. of Gotenda, Tokyo." On his 1960

8/ It should be noted that under Section 911(c)(6) of the 1954 Code, added by Section 11(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960, which was not in effect during the years at issue, the taxpayer's denial to the German authorities that he was a German resident would be conclusive evidence that he was not a bona fide resident of Germany, if the German authorities subsequently found him not subject to German income tax.

return, he stated that in 1958 he should have stated his foreign income was $13,400 instead of $9,000 (I-R. 92, 93), and for 1960 he reported $19,900 as tax exempt while "employed in promoting sales and repair of machines by operating, soliciting, demonstrating and teaching operation of machines etc. as under terms of agreement with Service Games Ltd. of Gotenda, Tokyo" (R. 93). In 1961, he stated his allegedly tax exempt income in 1960 should have been $21,952, and reported for 1961, $24,987 as exempt income while "Employed promoting sales and repairs of machines by soliciting, teaching and practicing the diagnosing and the manipulatic of machines, as under the terms of agreements with Service Games Ltd. of Gotenda, Tokyo." (I-R. 97, 98.)

Contrary to these sworn allegations, at the trial in the Tax Court the taxpayer admitted he had received no income whatsoever from Service Games Ltd. during the taxable years (II-R. 48) but he then testified that he earned income from teaching soldiers how to diagnose and manipulate sl machines under various oral agreements whereby he usually received the jackpots (II-R. 31). He was, however, unable to cite a single instance or name a single person from whom he received compensation for teaching how to manipulate the slot machines. There is, on the contrary, abundant evidence in the record to show that admittedly the taxpayer personally manipulated the machines. (II-R. 32, 52, 53, 61, 66.) The Tax Court concluded (I-R. 139), that even if the taxpayer's story were believed, which the Tax Court declined to do, "It was a type of joint venture betw petitioner and the soldiers--not a payment to petitioner by the soldiers for personal services which he rendered to them."

We submit that the Tax Court was clearly correct, and that none of the income which the taxpayer received abroad was "earned income" within

he meaning of the statute so as to be exempt from taxation under Section 11 of the 1954 Code. Section 4462(a)(2) of the Internal Revenue Code f 1954, Appendix A, infra, recognizes that slot machines are gaming evices. Rev. Rul. 55-171, 1955-1 Cum. Bull. 80, 87, Appendix A, infra, pecifically excludes gambling income from the compass of "earned income" tating (p. 87):

> Sec. 7. Earned Income.
>
> .01 Compensation for personal services rendered.--The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. It does not include such income as dividends, other distributions of corporate earnings or profits, gambling gains, interest, rents, or gains or profits from dealing in real or personal property. * * * (Emphasis supplied.)

his restrictive interpretation of "earned income" is proper and correct, n view of the general purpose of Section 911. This section was designed y Congress to be a relief provision, to ease the burden imposed on nited States citizens by Section 61 of the 1954 Code, Appendix A, infra, o report income regardless of where it may be earned. The special exemption rovisions of Section 911 should be strictly construed under the well-stablished rule of statutory construction that provisions granting relief r special exemption from income taxes are to be strictly construed. United tates v. Stewart, 311 U.S. 60, 71. Exclusions from gross income are a atter of legislative grace and the burden of showing the right thereto s on the taxpayer. Interstate Transit Lines v. Commissioner, 319 U.S. 590, 93, rehearing denied, 320 U.S. 809; Jones v. Kyle, 190 F. 2d 353 (C.A. 10th), ertiorari denied, 342 U.S. 886.

III

THE TAXPAYER IS PRECLUDED FROM RAISING THE MATTER OF THE STATUTE OF LIMITATIONS INASMUCH AS HE DID NOT RAISE THE ISSUE IN THE TAX COURT; AND IN ANY EVENT THE ASSESSMENT OF THE DEFICIENCIES ASSERTED AGAINST THE TAXPAYER WOULD NOT BE BARRED FOR FIVE OF THE TAXABLE YEARS

The taxpayer did not raise the issue of the statute of limitations in the Tax Court, and consequently neither the briefs filed in the Tax Court nor the findings of fact and opinion of the Tax Court discuss it. Here, for the first time, the taxpayer contends (Br. 9) that the first three taxable years (1956 through 1958) are barred by the statute of limitations. He does not attempt to raise the issue with respect to the years 1959, 1960, and 1961, nor could he do so, since the notice of deficiency was mailed September 18, 1962, or within the usual three year statutory period, provided in Section 6501(a) of the 1954 Code.

The general rule is that questions not raised in the trial courts may not be considered in the appellate courts. Helvering v. Wood, 309 U.S. 344; Helvering v. Tex-Penn Oil Co., 300 U.S. 481; Helvering v. Salvage, 297 U.S. 106; General Utilities Co. v. Helvering, 296 U.S. 200, 206; Duignan v. United States, 274 U.S. 195, 200; Shedd's Estate v. Commissioner, 320 F. 2d 638, 640-641 (C.A. 9th); Vogel's Estate v. Commissioner, 278 F. 2d 548, 550 (C.A. 9th); Bank of California v. Commissioner, 133 F. 2d 428, 430 (C.A. 9th). In Hormel v. Helvering, 312 U.S. 552, 558, the Supreme Court recognized an exception to the general rule where the obvious result would be a plain miscarriage of justice. See also MacRae v. Commissioner, 294 F. 2d 56, 59 (C.A. 9th), certiorari denied, 368 U.S. 955. No reason has been advanced in this

case for making an exception, and it is submitted that the facts of the taxpayer's case do not warrant doing so.

It has frequently been held that the defense of the statute of limitations may not be raised for the first time in the Court of Appeals when not pleaded in the Tax Court. Reeves v. Commissioner, 314 F. 2d 438 (C.A. 1st); Rice v. Commissioner, 295 F. 2d 239, 240 (C.A. 5th); Given v. Commissioner, 238 F. 2d 579, 583 (C.A. 8th); Covington v. Commissioner, 103 F. 2d 201 (C.A. 5th); Austin Co. v. Commissioner, 35 F. 2d 910, 912 (C.A. 6th), certiorari denied, 281 U.S. 735. No exceptional circumstances exist here which would warrant any different holding.

Moreover, the assessment of the deficiencies asserted against the taxpayer would not be barred by the statute of limitations in any event in five of the six years. Section 6501(e)(1) of the 1954 Code, Appendix A, infra, provides that if a taxpayer omits an amount in excess of 25% of his gross income as stated in the return, the tax may be assessed at any time within six years after the return was filed. It is recognized that subsection (e)(1)(A) (ii) of this part of the Code provides that in determining the amount omitted from gross income there shall not be taken into account any amount which is omitted from gross income stated in the return if the amount is disclosed in the return, or in a statement attached to it, so as to advise the Secretary or his delegate of the nature and amount of the item. As discussed in Point II of this Argument, supra, the taxpayer contended in his returns that various amounts were deductible as foreign income earned abroad under Section

911 of the Code, and did not include them in his gross income. The following table shows the amounts reported as taxable in the years in question, the additional amounts disclosed, and the amounts of the deficiencies asserted by the Commissioner (I-R. 45, 48, 52, 130, 131):

Years	1956	1957	1958
Amount reported taxable on returns	$ 889	$ 703	$ 2,162
Amount disclosed on returns as allegedly tax exempt	1,900	1,900	9,000
Total amount disclosed on returns	2,789	2,603	11,162
25 per cent of total amount disclosed on returns	697.25	650.75	2,790.50
Deficiencies asserted by Commissioner in statutory notice	20,178.12	13,033.69	12,749.68
Amount by which deficiencies exceed total amount disclosed	17,389.12	10,430.69	1,587.68

Since the deficiencies asserted by the Commissioner and affirmed by the Tax Court have not been shown to be clearly erroneous, as discussed above in Points I and II of this Argument, it is obvious that for 1956 and 1957 the taxpayer omitted more than 25 per cent of the amounts he disclosed on his returns. Even as to 1958, the asserted deficiency exceeds the amount disclosed on the return, but in that year not by 25 per cent. However, inasmuch as the taxpayer failed to raise an issue with respect to this issue in the Tax Court, he is precluded from doing

so for 1958 for the first time at this stage of the proceedings. In the event this Court should decide to remand this case to the Tax Court (See Appendix B, infra), the Commissioner would have no objection if this Court should direct the Tax Court to permit the taxpayer to amend his petition so as to raise the issue of the statute of limitations as to 1958. As to the other five years, the assessment of the deficiencies asserted against the taxpayer would not have been barred even if he had raised the issue below, so that it would be of no assistance to him to raise the issue as to those years on remand.

IV

THE TAX COURT CORRECTLY DECLINED TO CONSIDER THE REQUESTED ABATEMENT OF THE JEOPARDY ASSESSMENT AGAINST THE TAXPAYER

The taxpayer requests (Br. 13) that this Court order the Commissioner to return to him the monies seized from him by jeopardy assessment. As stated in the notice of deficiency (I-R. 44), a jeopardy assessment had been made against the taxpayer on August 14, 1962. Since it was made prior to the issuance of a notice of deficiency, the Commissioner duly issued his notice of deficiency on September 18, 1962, and within 60 days, as required by Section 6861(b) of the 1954 Code, Appendix A, infra. The taxpayer's petition, while mentioning that the jeopardy assessment had been made, and requesting the return of the money seized (I-R. 1, 3), did not deny the authority of the Commissioner to make it, nor, indeed, did it advance any reasons why jeopardy did not exist. During the trial, the taxpayer sought to

bring the matter of the jeopardy assessment into the case (II-R. 6, 16), and the Tax Court correctly stated (II-R. 16) that it had no authority to consider the jeopardy assessment, or to abate it.

The Commissioner is authorized to make such an assessment under Sect 6861(a) of the 1954 Code, Appendix A, infra. The making of a jeopardy assessment is a discretionary prerogative of the Secretary of the Treasury or his delegate. Phillips v. Commissioner, 283 U.S. 589, 596, fn. 599; Cohen v. United States, 297 F. 2d 760 (C.A. 9th), certiorari denied, 369 U.S. 865; Ginsburg v. United States, 278 F. 2d 470 (C.A. 1st), certiorari denied, 364 U.S. 878; Homan v. Long, 242 F. 2d 645 (C.A. 7th). It has the force of a judgment. Citizens Nat. Trust & S. Bank of Los Angeles v. United States, 135 F. 2d 527, 528 (C.A. 9th). Thus the District Director may make a jeopardy assessment whenever he believes that collection of the tax will be jeopardized by delay, and the exercise of the broad discretionary power is left to his personal judgment and opinion. The courts have declined to inquire into the District Director' belief or in any way substitute their judgment for that of the District Director. Cohen v. United States, supra; Lloyd v. Patterson, 242 F. 2d 742, 743-744 (C.A. 5th); Hilinski v. Commissioner, 237 F. 2d 703, 704 (C.A. 6th); Darnell v. Tomlinson, 220 F. 2d 894 (C.A. 5th). 9 Mertens, Law of Federal Income Taxation, Sec. 49.145, pp. 232-233. In this case, the taxpayer was out of the country, and engaged in an unusual and somewhat precarious type of occupation. The District Director may well have believed that the taxpayer might transfer or gamble away his assets so as to jeopardize the collection of his income taxes.

The taxpayer's institution of proceedings in the Tax Court and his appeal to this Court in no way operate to stay the Commissioner's hand from enforcing a jeopardy assessment in the absence of a bond. See Cohen v. United States, supra.

Under Section 6861(c), Appendix A, infra the Secretary or his delegate may abate a jeopardy assessment to the extent that the District Director believes it to be excessive, or to the extent that the taxpayer proves that no jeopardy exists, but no such authority exists after a Tax Court decision has been rendered. Prior to the Tax Court decision, the taxpayer could have filed an application for abatement with the District Director on the ground that jeopardy does not exist, fully stating the reasons and giving supporting evidence for the request. Darnell v. Tomlinson, supra; Treasury Regulations on Procedure and Administration (1954 Code), Sec. 301.6861-1(e) and 301.6861-1(f)(3). There is nothing to indicate that he ever filed such an application, or offered to file a bond.

Section 6512 of the 1954 Code, Appendix A, infra, gave the Tax Court jurisdiction to determine overpayments during the taxable years (I-R. 182-183), and pursuant to Section 6861(f) of the 1954 Code, at the conclusion of these proceedings, if the amount already collected exceeds the amount determined as the amount which should have been assessed, the excess will be credited or refunded to the taxpayer, as provided in Section 6402 of the 1954 Code, without the necessity of filing a claim therefor. This Court, however, should deny the taxpayer's request to consider the jeopardy assessment and should decline

to order the Commissioner to return the monies seized.

V

THE TAX COURT CORRECTLY IMPOSED ADDITIONS TO TAX UNDER SECTION 6654 OF THE 1954 CODE FOR THE TAXPAYER'S FAILURE TO FILE DECLARATIONS OF ESTIMATED TAX FOR THE YEARS 1956 THROUGH 1961

Section 6654 of the 1954 Code, Appendix A, infra, provides that in the case of any underpayment of estimated tax by an individual, with exceptions not pertinent here, specified penalties or additions to tax shall be imposed. Section 6015 of the 1954 Code, Appendix A, infra, with certain exceptions not here pertinent, requires every individual to make a declaration of his estimated tax. The Commissioner's notice of deficiency asserted (I-R. 44) that the taxpayer was liable for $1,303.66 because of additions to tax under this section for failure to file declarations of estimated tax for any of the six taxable years, 1956 through 1961. The taxpayer did not dispute this in his petition. At the trial he failed to present any evidence with respect to it, and thus made no explanation whatever as to why he filed no declarations of estimated tax. The Tax Court sustained the Commissioner's determination of liability. (I-R. 129, 141.)

The imposition of additions to tax provided for in Section 6654 of the 1954 Code has frequently been sustained. See, for example, Commissioner v. Acker, 361 U.S. 87; Hansen v. Commissioner, 258 F. 2d 585 (C.A. 9th), reversed on other grounds, 300 U.S. 446; United States v. Steck, 295 F. 2d 682 (C.A. 10th); Woo v. Commissioner, 345 F. 2d 532 (C.A. 5th); Kaltreider v. Commissioner, 255 F. 2d 833 (C.A. 3d). In

the light of the record, which clearly shows that the taxpayer failed to file declarations of estimated tax, it is submitted that the Tax Court correctly affirmed the Commissioner's determination.

CONCLUSION

The decision of the Tax Court was correct on all issues, and should be affirmed.

Respectfully submitted,

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OCTOBER, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1966.

_____
CAROLYN R. JUST
Attorney

APPENDIX A

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) General Definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * *

(26 U.S.C. 1964 ed., Sec. 61.)

SEC. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(26 U.S.C. 1964 ed., Sec. 262.)

SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.

(a) General Rule.--The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:

(1) Bona fide resident of foreign country.--In the case of an individual citizen of the United States, who establishes to the satisfaction of the Secretary or his delegate that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) if such amounts constitute earned income (as defined in subsection (b)) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this paragraph.

(2) Presence in foreign country for 17 months.--In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or an agency thereof) if such amounts constitute earned income (as defined in subsection (b)) attributable to such period; but such individual shall not be allowed as a deduction from his gross income any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable or or chargeable against amounts excluded from gross income under this paragraph. If the 18-month period includes the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed $20,000. If the 18-month period does not

include the entire taxable year, the amount excluded under this paragraph for such taxable year shall not exceed an amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18-month period bears to the total number of days in such year.

(b) Definition of Earned Income.--For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary or his delegate, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered as earned income.

(26 U.S.C. 1964 ed., Sec. 911.)

SEC. 4462. DEFINITION OF COIN-OPERATED AMUSEMENT OR GAMING DEVICE.

(a) In General.--As used in sections 4461 to 4463, inclusive, the term "coin-operated amusement or gaming device" means--

* * *

(2) so-called "slot" machines which operate by means of insertion of a coin, token, or similar object and which, by application of the element of chance, may deliver, or entitle the person playing or operating the machine to receive cash, premiums, merchandise, or tokens.

* * *

(26 U.S.C. 1964 ed., Sec. 4462.)

SEC. 6015.[9] DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS.

(a) Requirement of Declaration.--Every individual * * * shall make a declaration of his estimated tax for the taxable year if--

---

9/ Section 6015 was amended by Sec. 5(a) of the Act of September 14, 1960, P.L. 86-779, 74 Stat. 998, effective for the year 1961 in respect not material to this case.

(1) the gross income for the taxable year can reasonably be expected to consist of wages (as defined in section 3401 (a)) and of not more than $100 from sources other than such wages, and can reasonably be expected to exceed--

(A) $5,000, in the case of a single individual other than a head of a household (as defined in section 1 (b) (2)) or a surviving spouse (as defined in section 2 (b)) or in the case of a married individual not entitled to file a joint declaration with his spouse;

* * *

(26 U.S.C. 1964 ed., Sec. 6015.)

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * *

(e) Omission From Gross Income.--Except as otherwise provided in subsection (c)--

(1) Income taxes.--In the case of any tax imposed by subtitle A--

(A) General rule.--If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. * * *

* * *

(26 U.S.C. 1964 ed., Sec. 6501.)

SEC. 6512. LIMITATIONS IN CASE OF PETITION TO TAX COURT.

(a) Effect of Petition to Tax Court.--If the Secretary or his delegate has mailed to the taxpayer a notice of deficiency under section 6212 (a) (relating to deficiencies of income, estate, and gi taxes) and if the taxpayer files a petition with the Tax Court withi the time prescribed in section 6213 (a), no credit or refund of inco tax for the same taxable year, of gift tax for the same calendar yea or of estate tax in respect of the taxable estate of the same decede in respect of which the Secretary or his delegate has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of the tax shall be instituted in any court except--

(1) As to overpayments determined by a decision of the Tax Court which has become final; and

(2) As to any amount collected in excess of an amount computed in accordance with the decision of the Tax Court which has become

(3) As to any amount collected after the period of limitation upon the making of levy or beginning a proceeding in court for collection has expired; but in any such claim for credit or refund or in any such suit for refund the decision of the Tax Court which has become final, as to whether such period has expired before the notice of deficiency was mailed, shall be conclusive.

(b) Overpayment Determined by Tax Court.--

(1) Jurisdiction to determine.--If the Tax Court finds that there is no deficiency and further finds that the taxpayer has made an overpayment of income tax for the same taxable year, of gift tax for the same calendar year, or of estate tax in respect of the taxable estate of the same decedent, in respect of which the Secretary or his delegate determined the deficiency, or finds that there is a deficiency but that the taxpayer has made an overpayment of such tax, the Tax Court shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Tax Court has become final, be credited or refunded to the taxpayer.

(2) Limit on amount of credit or refund.--No such credit or refund shall be allowed or made of any portion of the tax unless the Tax Court determines as part of its decision that such portion was paid--

(A) after the mailing of the notice of deficiency, or

(B) within the period which would be applicable under section 6511 (b) (2), (c), or (d), if on the date of the mailing of the notice of deficiency a claim had been filed (whether or not filed) stating the grounds upon which the Tax Court finds that there is an overpayment.

(26 U.S.C. 1964 ed., Sec. 6512.)

SEC. 6654. FAILURE BY INDIVIDUAL TO PAY ESTIMATED INCOME TAX.

(a) Addition to the Tax.--In the case of any underpayment of estimated tax by an individual, except as provided in subsection (d), there shall be added to the tax under chapter 1 for the taxable year an amount determined at the rate of 6 percent per annum upon the amount of the underpayment (determined under subsection (b)) for the period of the underpayment (determined under subsection (c)).

* * *

(26 U.S.C. 1964 ed., Sec. 6654.)

SEC. 6861. JEOPARDY ASSESSMENTS OF INCOME, ESTATE, AND GIFT TAXES.

(a) Authority for Making.--If the Secretary or his delegate believes that the assessment or collection of a deficiency, as defined in section

6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213 (a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and demand shall be made by the Secretary or his delegate for the payment thereof.

(b) Deficiency Letters.--If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 6212 (a), then the Secretary or his delegate shall mail a notice under such subsection within 60 days after the making of the assessment.

(c) Amount Assessable Before Decision of Tax Court.--The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 6212 (c) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Tax Court. The Secretary or his delegate may, at any time before the decision of the Tax Court is rendered, abate such assessment, or any unpaid portion thereof, to the extent that he believes the assessment to be excessive in amount. The Secretary or his delegate shall notify the Tax Court of the amount of such assessment, or abatement, if the petition is filed with the Tax Court before the making of the assessment or is subsequently filed, and the Tax Court shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

* * *

(g) Abatement if Jeopardy Does Not Exist.--The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with the Tax Court, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and levy or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the day on which such jeopardy assessment is abated.

* * *

(26 U.S.C. 1964 ed., Sec. 6861.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.262-1 Personal, living, and family expenses.

* * *

(b) Examples of personal, living, and family expenses. Personal, living, and family expenses are illustrated in the following examples:

* * *

(5) Expenses incurred in traveling away from home (which include transportation expenses, meals, and lodging) and any other transportation expenses are not deductible unless they qualify as expenses deductible under section 162, § 1.162-2, and paragraph (d) of § 1.162-5 (relating to trade or business expenses), * * * section 212 and § 1.212-1 (relating to expenses for production of income), * * *. The taxpayer's costs of commuting to his place of business or employment are personal expenses and do not qualify as deductible expenses. The costs of the taxpayer's lodging not incurred in traveling away from home are personal expenses * * *. Except as permitted under section 162, 212, or 217, the costs of the taxpayer's meals not incurred in traveling away from home are personal expenses.

* * *

(26 C.F.R., Sec. 1.262-1.)

§ 1.446-1 General rule for methods of accounting.

* * *

(b) Exceptions. (1) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Commissioner, does clearly reflect income.

* * *

(26 C.F.R., Sec. 1.446-1.)

§ 1.911-1 [as amended by T.D. 6665, 1963-2 Cum. Bull. 27] Earned income from sources without the United States.--

(a) Bona fide resident of a foreign country--* * *

* * *

(8) Declaration of estimated tax. In estimating his gross income for the purpose of making a declaration of estimated tax for any taxable year, a citizen of the United States is not required to take into account income which it is reasonable to believe will be excluded from gross income under the provisions of section 911 (a) (1) and the regulations thereunder.

* * *

(26 C.F.R., Sec. 1.911-1.)

Treasury Regulations on Procedure and Administration (1954 Code):

§ 301.6501(e)-1 Omission from return.

(a) Income taxes--(1) General rule. (i) If the taxpayer omits from the gross income stated in the return of a tax imposed by subtitle A of the Code an amount properly includible therein which is in excess of 25 percent of the gross income so stated, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

(ii) For purposes of this subparagraph, the term "gross income", as it relates to a trade or business, means the total of the amounts received or accrued from the sale of goods or services, to the extent required to be shown on the return, without reduction for the cost of such sales or services. An item shall not be considered as omitted from gross income if information, sufficient to apprise the district director of the nature and amount of such items, is disclosed in the return or in any schedule or statement attached to the return.

* * *

(26 C.F.R., Sec. 301.6501(e)-1.)

Rev. Rul. 55-171, 1955-1 Cum. Bull. 80, 87:

* * *

Sec. 7. Earned Income.

.01 Compensation for personal services rendered.--The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. It does not include such income as dividends, other distributions of corporate earnings or profits, gambling gains, interest, rents, or gains or profits from dealing in real or personal property. * * *

* * *

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DANIEL A. ROBIDA,	)	
	)	
Petitioner	)	
	)	
v.	)	No. 20,592
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent	)	

MOTION OF RESPONDENT TO REMAND THE CASE TO THE TAX COURT

Comes now the Commissioner of Internal Revenue, the Respondent herein, by his counsel of record, and respectfully moves this Court as follows:

WHEREAS,

1. This case involves deficiencies in income taxes for the years 1956 through 1961 totalling $46,559.55, from income which the Tax Court found had been derived by the taxpayer from gambling with slot machines while traveling abroad during the years in question. The Tax Court sustained the Commissioner's computation of the deficiencies by the net worth plus nondeductible expenditure method and rejected the taxpayer's primary contention that he had received the money as compensation for services rendered outside the United States while allegedly teaching others to diagnose and manipulate slot machines so as to collect jackpots.

2. The taxpayer has filed a petition for review with this Court from the Tax Court's decision in favor of the Commissioner; the brief on behalf of the taxpayer was received on June 21, 1966, and the brief

on behalf of the Commissioner is now due on July 21, 1966.

3. The principal contention of the taxpayer's brief (pp. 2-13) is that he was unable to prove his case before the Tax Court, where he was not represented by counsel, allegedly because he did not have certain personal records which had been seized by the German police when he was expelled from Germany in 1963.

4. Counsel for Respondent has been informed by the Chief Counsel of the Internal Revenue Service that its San Francisco office, prior to the Tax Court trial, made copies of all such records (i.e. certain diaries of the taxpayer) then in its possession available to the petitioner for his inspection; that petitioner inspected the documents; and that petitioner was advised that he could make use of them at the trial if he so desired.

5. On May 13, 1966, prior to the filing of the taxpayer's brief, counsel for the Respondent, despite the fact that the material is not of record in this case, furnished the taxpayer's counsel with a xeroxed copy of photostats of such diaries of the taxpayer during the taxable years, transmitted with the Internal Revenue Service files in this case. (See Appendix B of the taxpayer's brief.) This action was taken mainly because the taxpayer was not represented by counsel before the Tax Court.

6. On receipt of the taxpayer's brief, which simply reprints (Appendix B) Respondent's transmittal letter of May 13, 1966, counsel for Respondent, on June 22, 1966, telephoned counsel for the taxpayer and indicated, in the interest of complete fairness, a willingness that the case be remanded to the Tax Court to enable the taxpayer to offer

into evidence and to testify concerning such portions, or all, of the copies of the diaries which he believes may be relevant to his case.

NOW THEREFORE,

Counsel for the Respondent with the concurrence of the Chief Counsel of the Internal Revenue Service hereby moves that this Court enter an order remanding the case to the Tax Court to permit the taxpayer to offer and testify concerning the aforementioned material in proceedings therein; and

IN THE ALTERNATIVE, in the event this Court should deny the aforesaid Motion, the Commissioner of Internal Revenue, by his counsel of record, respectfully moves that this Court extend the time for filing the brief on behalf of the Respondent for 60 days, or until September 19, 1966, * * * .

MITCHELL ROGOVIN
Assistant Attorney General
Counsel for the Respondent

Dated: June 24, 1966.

[Caption Omitted]

ANSWER OF THE COMMISSIONER TO PETITIONER'S MOTION IN OPPOSITION TO MOTION TO REMAND AND MOTION FOR FINAL JUDGMENT

Comes now the Commissioner of Internal Revenue, the Respondent herein, by his counsel of record, and respectfully states to this Court as follows:

1. The taxpayer has misinterpreted the Commissioner's motion to remand the case to the Tax Court, and is endeavoring to have the taxpayer's appeal decided without the benefit of the Commissioner's brief or oral argument. The Commissioner has never confessed error in this case and he stands ready to file his brief and present oral argument in the event this Court should enter an order that the Commissioner proceed to brief the case in accordance with paragraph 5(b) herein. There is, of course, no reason for the Commissioner to seek a new trial, as alleged, inasmuch as the Tax Court has decided the case in the Commissioner's favor.

2. The taxpayer has misrepresented both the facts and the law. The Commissioner's abandonment, prior to trial in the Tax Court, of the claim for a 50% fraud penalty for the taxable years 1956 through 1961, originally made in the notice of deficiency dated September 18, 1962 (R. I-43), did not in any way affect the deficiency in tax totalling $46,559.55 claimed for those years. The Commissioner has never abandoned his claim as to the deficiency for those years, nor has he ever abandoned the determination that there were grounds for jeopardy assessment, entirely apart from the abandoned claim for fraud.

3. That the notice of deficiency was not based on any of the material seized from the taxpayer by the German police is clearly shown by the fact that such notice is dated September 18, 1962 (R. I-43) and that the seizure of the taxpayer's records by the German police was not until July, 1963 (R. 41). In fact, the opening net worth used in the Commissioner's computation of the taxpayer's deficiencies for 1956

through 1961 is the same figure agreed upon as the closing net worth for 1955 in a prior case settled with the taxpayer involving the years 1949 through 1955. (R. 36.)

4. With respect to the xerox copies of certain photostats of the taxpayer's notebooks seized by the German police, there is attahced hereto an affidavit from Eugene H. Cirrani, Esq., the attorney with the Internal Revenue Service who tried the case in the Tax Court, which shows what material he had received prior to the trial in the Tax Court. The circumstances of the taxpayer's incarceration in Germany are entirely irrelevant to the instant tax case. The originals of the five notebooks were not received from Germany until May, 1966, as shown by the certified copies of letters from the files of the Internal Revenue Service, also attached, when they were requested in connection with a pending suit for refund involving years subsequent to those here in issue. The notebooks are clearly marked "Property of Daniel A. Robida", and a comparison of the photostats and the xerox copies of the photostats with the originals discloses that the xerox copy furnished to the taxpayer's attorney was complete and in the exact order of the originals with the exception of blank pages in the notebooks. Mr. Ciranni's affidavit also confirms the manner in which the taxpayer was permitted to inspect the photostats of the notebooks and that he declined to identify them as his. The taxpayer should not be permitted to obtain a reversal of the Tax Court's judgment affirming the Commissioner's notice of deficiency by a mere failure to identify his own records.

5. (a) The Commissioner desires to give the taxpayer every opportunity to offer into evidence and to testify concerning such portions, or all, of the diaries which he may believe to be relevant to his case, particularly since he was not represented by counsel before the Tax Court. For this reason, the Commissioner reiterates his motion that this Court remand the case to the Tax Court to give the taxpayer full opportunity to make whatever use he can make of his records, now that he is represented by counsel.

(b) The Commissioner is entirely satisfied with the record which was made in the Tax Court, and we believe the Tax Court was correct in sustaining the deficiencies. If the taxpayer's motion in opposition to remand should be interpreted to mean that the taxpayer does not wish to take advantage of the opportunity to present further evidence from his note books which have been made available to him and that he wishes to have his liability determined on the basis of the record made in the Tax Court, then, in the alternative, in view of the delay incurred by the taxpayer's motion in opposition to remand, the Commissioner respectfully moves thatthis Court extend the time for filing the brief on behalf of the Commissioner until 30 days after receipt of an order that such brief be filed.

(c) The taxpayer's motion for final judgment should in either event be denied.

Respectfully submitted,

/s/ Mitchell Rogovin
MITCHELL ROGOVIN
Assistant Attorney General
Counsel for the Commissioner

August 22, 1966.

* * *

[Caption Omitted]

AFFIDAVIT

tate of California)
) ss
ounty of San Francisco)

I, Eugene H. Ciranni, being first duly sworn, depose and say:

1. THAT I am an attorney in the San Francisco Regional Counsel's ffice, of the Internal Revenue Service;

2. THAT I had primary responsibility for the trial of the above-ntitled case in the Tax Court of the United States;

3. THAT three envelopes, marked "A", "B", and "C", were a part f the official case file in this matter;

4. THAT the envelope marked "A" contained photostatic copies f five notebooks or diaries each containing, among other entries, he statement "property of Daniel A. Robida";

5. THAT the envelope marked "B" contained photostatic copies of orrespondence between Daniel A. Robida and certin Swiss banks;

6. THAT the envelope marked "C" contained photostatic copies f correspondence of a personal nature between Daniel A. Robida and thers, some of which made reference to his United States individual ncome tax returns for the years 1956, 1960, and 1962;

7. THAT according to written memoranda contemporaneously pre-ared by affiant with respect to conferences held between Daniel A. obida and affiant, which memoranda are a part of the official files n this matter, Daniel A. Robida was advised by affiant:

(a) THAT photostatic copies of five diaries of Daniel A. Robida were in the official Internal Revenue Service files;

(b) THAT Daniel A. Robida could examine such photostats whenever he wished and could rely on them in any manner; but

(c) THAT the affiant, acting on behalf of the Commissioner, could not introduce such photostats into evidence because the photostats were not properly authenticated and because Daniel A. Robida would not stipulate as to the accuracy of such photostats;

8. THAT Daniel A. Robida did in fact examine such photostats in the presence of affiant, in the office of affiant, on September 16, 1964, September 22, 1964, and October 13, 1964, and he took notes from those photostats on each of those occasions.

9. THAT the original diaries of Daniel A. Robida from which the photostats in the envelope marked "A" were taken, were not in the possession of the affiant either prior to or during the Tax Court trial, and in fact have never been seen by the affiant, and

10. THAT prior to the trial of this case affiant suggested to Daniel A. Robida on several occasions that he stipulate that the photostatic copies of the diaries contained in the envelope marked "A" were, in fact, accurate copies of his original diaries, but he refused to do so.

/s/ Eugene H. Ciranni
Eugene H. Ciranni
Attorney

Subscribed and sworn to before me this seventeenth day of August, 1966.

/s/ Marjorie S. Hamburger
Notary Public in and for the
City and County of San
Francisco, State of California
My Commission Expires Sept. 24,

EMORANDUM
REGISTERED - AIR MAIL

O: Associate Chief, Appellate Division
San Francisco, Calif. - AP:SF:AS:RWM

DATE: AUG 15 1963

ROM: Office of International Operations
National Office (CP:IO:3:HWD)

UBJECT: Daniel A. Robida
Last known forwarding address:
c/o American Express Company
30 Wilhelmstrasse
Wiesbaden, Germany

With reference to our recent correspondence with your office in regard to the above-named taxpayer, there is transmitted herewith the material in the form of photostats made available by the Army and Air Force to our London office, as follows:

Contents of taxpayer's notebooks (5) - Envelope A

Correspondence between taxpayer and Swiss banks - Envelope B

Other correspondence and copies of taxpayer's returns for 1956, 1960, and 1962 - Envelope C.

/s/ H. W. Driscoll

Attachments

UNITED STATES DEPARTMENT OF JUSTICE

Washington, D.C.

March 14, 1966

RMR:JF:WAMiner:ldb
5-11-2442

Honorable Mitchell Rogovin
Chief Counsel
Internal Revenue Service
Washington, D.C. 20224

Re: Daniel A. Robida v. United States
Civil No. 44081 - ND California
Your ref: CC:RL-6597 S:HHPlaut/lp

Dear Mr. Rogovin:

With reference to the photostat copies of the diaries of Mr. Robida, previously furnished this office, it is requested that you ascertain the whereabouts of the originals of these diaries. If the originals are unavailable we must know this in order that we may so inform the Court in preparation for the introduction of the photostats as secondary evidence.

Sincerely yours,

RICHARD M. ROBERTS
Acting Assistant Attorney General
Tax Division

By:
JEROME FINK
Chief, Refund Trial Section No. 3

MEMORANDUM
CC:RL-6597 S:HHPlaut/lp

TO: DIRECTOR OF INTERNATIONAL OPERATIONS DATE: MAR 17 1966
CP:IO:3:HBH

FROM: REFUND LITIGATION DIVISION

SUBJECT: Daniel A. Robida v. United States
Civil No. 44081 (ND Calif.)

We would appreciate it if you would comply with the request of the Department of Justice contained in their letter dated March 14, 1966, a copy of which is enclosed herewith.

We have had previous correspondence in this matter. Please refer to your memoranda of January 25, 1966, January 26, 1966 and February 18, 1966.

Your reply should be forwarded to this office for transmittal to the Department of Justice.

/s/ Jerome D. Sebastian
Jerome D. Sebastian
Chief, Special Income Tax Branch

Encl. No. 30:
copy of letter dated 3-14-66

MEMORANDUM

TO: Office of International Operations
CP:IO:3:HBH

Date: 14 APR 1966 (66-

FROM: Revenue Service Representative - Bonn
CP:IO:307 /s/ JLC

SUBJECT: Daniel A. Robida v. United States
Civil No. 44081 ND Calif.

The original diaries of Robida were delivered by the Wiesbaden police to the States Attorney in that city on December 14, 1964. A check on the whereabouts and availability of these diaries is now being made in the States Attorney's office and we will be advised of the results in the near future.

MEMORANDUM
REGISTERED

TO: Office of International Operations
CP:IO:3:HBH

DATE: 3 MAY 1966 (66-98)

FROM: Revenue Service Representative - Bonn
CP:IO:307 /s/ JLC

SUBJECT: Daniel A. Robida v. United States

Transmitted herewith are the five notebooks or diaries seized from Robida by the Wiesbaden police. The letter from the Department of Justice to the Chief Counsel did not indicate any necessity for certification of these documents, so I assume Mr. Dody of O.S.I. or Mr. Hayes of C.I.D. will be able to identify them if they are offered in evidence by the Government.

Attachments - 5

MEMORANDUM

TO: Director, Refund Litigation Division
Office of Chief Counsel
CC:RL:S - H.H. Plaut

DATE: MAY 10 1966

FROM: Director of International Operations
CC:IO:3:HBH

SUBJECT: Daniel A. Robida v. United States
Civil Number 44081 (ND Calif.)

Transmitted herewith are the five notebooks or diaries seized from Daniel A. Robida by the Wiesbaden, Germany police.

/s/ C. d. Fox

Attachment

No. 20,592

United States Court of Appeals

For the Ninth Circuit

ANIEL A. ROBIDA,
Petitioner,
vs.
OMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONER'S REPLY BRIEF

HN R. SWENDSEN,
126 Post Street,
San Francisco, California 94108,
Attorney for Petitioner.

NAU-WALSH PRINTING CO., SAN FRANCISCO

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No. 20,592

United States Court of Appeals
For the Ninth Circuit

DANIEL A. ROBIDA, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

PETITIONER'S REPLY BRIEF

THE PRINCIPAL CONTROVERSY ON THIS APPEAL IS WHETHER THE DECISION OF THE TAX COURT SHOULD BE REVERSED AND REMANDED FOR NEW TRIAL

OR

WHETHER JUDGMENT SHOULD BE ENTERED FOR ROBIDA

1. The Commissioner Admits No Fair Trial

The Commissioner of Internal Revenue admits that there was no fair trial because the Government had access to Robida's records and not only failed to produce them but failed to make them available to Robida (see Respondent's Motion to Remand—Respondent's Brief 41-43).

2. The Commissioner Now Offers to Make Only a Part of Mr. Robida's Records Available

The CIR in his Motion to Remand hopes to cure the injustice by making *part* of Robida's records available to him (see Ciranni's Affidavit—Respondent's Brief 47-48). (Some copies; some originals; all unauthenticated. [See Respondent's intergovernmental memoranda, Respondent's Brief 49-54].)

(Compare Robida's Affidavit in Appendix B of this Brief, detailing his records, with intergovernmental memoranda (Respondent's Brief 49-54) and Ciranni's Affidavit (Respondent's Brief 47-48) showing only part of records now being offered by Government.)

3. The Question Is Whether the Government Can Force a New Trial on Just the Records It Chooses

The main controversy boils down to the issue of whether a fair trial is now possible. The impossibility of a fair trial is shown by Robida's allegations in his Affidavit in support of his Motion for Judgment (Appendix B) wherein he shows the nature and extent of seized records and limited access accorded him, and the failure of the Government to controvert those allegations in any effective way. It should be noted that the governmental correspondence (Respondent's Brief 49-54) confirms Robida's allegations that the Government has access to his records. It should also be noted that Ciranni's Affidavit (Respondent's Brief 47-48) does not in any way deny Robida's description of the limited access that was afforded him of the photostats of the five notebooks.

THE SECONDARY CONTROVERSY IS WHETHER THE TRIAL COURT ERRED AS A MATTER OF LAW IN NOT ENTERING JUDGMENT FOR ROBIDA

1. The CIR Failed to Follow Mandatory Code Procedure in Making Jeopardy Assessment and Deficiency Determination

(a) Code Requirements for Notices

The statutes clearly distinguish between deficiency procedures under Int. Rev. Code §6211 through §6216, where assessments and collections necessarily follow a determination of deficiency, and a jeopardy assessment under Int. Rev. Code §6861 through §6864, where both assessments and collections may precede a notice of deficiency or a determination by the Tax Court.

These safeguards include Int. Rev. Code §6303(a)[1] and §6861(a),[2] requiring a notice of demand for payment addressed to the taxpayer for payments of amounts assessed *before the Commissioner can levy*

---

[1] §6303(a) reads:

"(a) General Rule.—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and *demanding payment thereof*. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address." (Emphasis added)

[2] §6861(a) reads:

"(a) Authority for Making.—If the Secretary or his delegate believe that the assessment or collection of a deficiency, as defined in section 6211, will be jeopardized by delay, he shall, notwithstanding the provisions of section 6213(a), immediately assess such deficiency (together with all interest, additional amounts, and additions to the tax provided for by law), and notice and *demand* shall be made by the Secretary or his delegate for *the payment* thereof." (Emphasis added)

and collect the amounts assessed, and §6861(b)[3] requiring a notice of deficiency under Int. Rev. Code §6212(a).[4]

Two notices are clearly required under the Code, as was held in *United States v. Ball,* 326 F.2d 898. *Ball* held that the failure to show notice was a jurisdictional defect and "not capable of cure by appellant's failure to raise and present it squarely to the lower court."

(b) Constitutional Need for Notices

Because of the nearly absolute discretion given to the Commissioner in making jeopardy assessments, Congress has provided various safeguards to protect the taxpayer from what could otherwise result in a deprivation "of life, liberty, or property, without due process of law" in violation of the Fifth Amendment to the Constitution.

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[3]§6861(b) reads:

"(b) Deficiency Letters.—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 6212(a), then the Secretary or his delegate shall mail a notice under such subsection within 60 days after the making of the assessment."

[4]§6212(a) reads:

"(a) In General.—If the Secretary or his delegate determines that there is a deficiency in respect of any tax imposed by subtitles A or B, he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail."

(c) Notices Were Not Given

The Commissioner made no showing of having mailed the taxpayer a demand for payment of amounts assessed. Instead, the records clearly show that collection by levy of amounts assessed was started by the Commissioner August 29, 1962, before mailing to the taxpayer a notice of deficiency (I-R. 148-169) on September 18, 1962 (I-R. 44). A demand for payment is necessary if the taxpayer is to be allowed his rights under Int. Rev. Code Section 6863 on stay of collection of jeopardy assessments. As amounts assessed were collected by the Commissioner before the mailing of the notice of deficiency, and no notice of demand for payment was ever given, the taxpayer was effectively denied his right to file a bond to stay collection.

For this reason, as well as other reasons, the Tax Court should have set aside jeopardy assessments and ordered the return of all amounts assessed to the taxpayer. As stated by the Federal Court in *Darnell v. Tomlinson,* 220 F.2d 894, a jeopardy assessments procedure is an exception to the normally accepted method of assessment and collection of taxes and it should never be used either as additional penalty or in any other improper manner.

2. The CIR Got Around the Statute of Limitations by Use of False Fraud Charges

(a) Jeopardy and Deficiency Were Based on Fraud

Both the jeopardy assessment and deficiency determination of August 14, 1962, were based on failure to

file (I-R. 43-45)[5] which was the ground for fraud (II-R. 17, ll. 10-13). The years 1956, 1957, 1958 were *then* outlawed by Int. Rev. Code §6501(a).

(b) Admission of No Fraud Was an Admission of No Jeopardy

The Commissioner's admission of abandonment of the fraud charge on October 5, 1964, was tantamount to an admission that no jeopardy and no deficiency existed; the CIR cannot claim inadequacy of records.

(c) Admission of No Jeopardy Amounted to Abatement

The admission of no jeopardy and no deficiency constituted an abatement of the jeopardy assessment and claim of deficiency as a matter of law. The Commissioner in fact abated the jeopardy assessment and claim of deficiency before it was announced in Court on October 5, 1964. At the time he filed his answer denying that Petitioner had filed his tax returns, the Commissioner in fact knew that Petitioner had in fact filed his tax returns (II-R. 16-17).[6]

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[5]The September 18, 1962 notice of deficiency says:

"Assessment of the deficiencies and penalties has been made under the provisions of the internal revenue laws applicable to jeopardy assessments." (I-R. 43)

The accompanying statement says:

"In the absence of adequate records, your taxable income has been computed . . .".

"The 50 percent penalty shown herein has been asserted under the provisions of section 6653(b) of the Internal Revenue Code of 1954." (I-R. 44)

Page 2 of the statement (I-R. 45) says:

"Since no return was filed for the taxable year 1956, your taxable income has been determined as follows: . . ."

The statement makes the same claim of no return filed for each of the affected years (I-R. 44, 51, 54, 57, 60).

[6]At the trial Mr. Robida inadvertently referred to a "time in November". The letter in question was actually dated December 19, 1962. It is attached hereto as part of Appendix B, page

(d) Statute of Limitations Had Run on Years 1956-1960 When Government Announced Abandonment of Jeopardy Grounds

On October 5, 1964, when the CIR *announced* abandonment of all of his grounds for jeopardy assessment and deficiency determination, the three year statute of limitations had then run on all of the affected years (1956-1961) except the year 1961, the return for which was filed in 1962.

(e) 1961 Is Barred by Statute Now.

It was then open to the Commissioner to make a new deficiency determination for 1961, but he failed to do so. All of the affected years are now barred by §6501(a).

3. The Net Worth Method Was Not Open to the Commissioner

The Commissioner correctly states (Brief page 15) that he is justified in using the net worth method where a taxpayer's records are non-existent or where they are considered incomplete, inaccurate, or in some manner unsatisfactory. Of course, that route is not open to the government where the government has access to the taxpayer's records, and the taxpayer does not and the government, as here, either fails to produce the records or to make them available to the taxpayer so that he can produce them.

4. Net Worth Was Not Proved

The government did not produce any independent evidence as to opening net worth. The stipulation as

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xxvi. It is to be noted that the letter incorrectly advises Mr. Robida that "This office cannot set aside the assessment, nor entertain a protest . . ." but correctly advises him that the matter is within the jurisdiction of the Tax Court.

to opening net worth claimed on page 20 of the Commissioner's Brief is non-existent. The government had the burden of proving net worth because, among other reasons, the government had access to Robida's records and Robida did not. The stipulation upon which the government claims to rely is in fact a disclaimer of any liability for the years as to which the stipulation is said to exist (I-R. 36).

THE TAX COURT HAD AUTHORITY TO DETERMINE ALL AMOUNTS ASSESSED AND TO RECOGNIZE AN ABATEMENT OF THE JEOPARDY ASSESSMENT

The statutory scheme clearly gives the Tax Court authority to redetermine the amounts assessed by way of jeopardy assessment. This power of the Tax Court is undoubtedly required by the Fifth Amendment to the Constitution and was given to the Tax Court by Congress in furtherance of constitutional requirements.

1. Assessment After Notice of Deficiency

Under Int. Rev. Code Section 6404(b),

> "no claim for abatement shall be filed by a taxpayer in respect of an assessment of any tax imposed under subtitle A or B."

Where assessment follows a notice of deficiency, sufficient judicial review of administrative determination is provided for in either the Tax Court or, if the taxpayer pays the tax, in the Court of Claims or a Federal District Court.

2. Assessment and Collection Before Court Review

However, in a jeopardy assessment before a decision of a Tax Court, the Tax Court must have broader jurisdiction than in its jurisdiction over an ordinary petition to redetermine a deficiency; otherwise, judicial review would not be effectively provided for on administrative actions. It is undoubtedly for this reason and in respect of constitutional government that Congress in enacting Int. Rev. Code Section 6861(c) gives the Tax Court

> ". . . jurisdiction to redetermine the entire amount of the deficiency and of *all amounts assessed* at the same time in connection therewith." (Emphasis added)

Where a jeopardy assessment is made before the decision of the Tax Court, a limited power in the Tax Court only to redetermine the deficiency would be meaningless since the Court could take no action to abate, or to set aside in part or in whole, the actual assessment. Where collection of the amounts assessed has preceded a Tax Court decision, the taxpayer would have no right to a refund of amounts assessed and collected unless he could sue for a refund.

The statutory scheme is clear: Where assessment but *not* collection precedes a Tax Court decision, the Tax Court has jurisdiction to redetermine the deficiency and amounts assessed; and where collection of amounts assessed *precede* the Tax Court decision, the Tax Court has authority *to order the return of all* amounts collected, by either a cash refund or by credit.

3. A Suit for Refund Is Not Necessary

Under Int. Rev. Code Section 6861(f), it is clear that a suit for refund is not necessary since this section provides:

> "If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in Section 6402, without the filing of claim therefor."

The intent of Congress is clear: The Tax Court has jurisdiction to finally dispose of all matters relevant to a jeopardy assessment where collection of amounts assessed precede the Tax Court decision.

THE COMMISSIONER'S ARGUMENT ON DENIAL OF EXEMPTION UNDER INTERNAL REVENUE CODE SECTION 911 IS NOT GERMANE TO THE ISSUES. HIS POSITION FALLS BECAUSE OF THE TRUE ISSUE IN THE CASE: UNFAIR TRIAL; BURDEN OF PROOF; STATUTE OF LIMITATIONS

Respondent's Brief is not responsive to the issues raised in either Appellant's Opening Brief or in his Motion for Judgment. The Commissioner's argument on §911 is one example, and for that reason will be treated more fully in Appendix A to this Brief.

All issues in this case depend upon the controversy as to fairness.

1. Failure of IRC to Produce Records Amounted to an Admission of Correctness of Returns

The Commissioner's refusal to produce Robida's records and his denial of those records to Robida not

only cast the burden of proof as to all issues upon the Commissioner, including any issue as to the operation and effect of Int. Rev. Code §911, but also prevented and still prevent Robida from making any effective showing in support of his income tax reports as filed. The government's failure in this regard is tantamount to an admission that Robida's income tax returns were correct as filed. That correctness should now be recognized by the Court.

2. Attempted Disallowance of §911 Exemption Was Based on Fraud

Since the government's deficiency determinations and jeopardy assessments were both made on the grounds of failure to file, fraud and inadequacy of records and since none of those grounds are now available to the Commissioner no claim of the Commissioner based on those grounds, including any attempted disallowance of exemption under §911 is now available to the Commissioner.

3. After CIR Abated the Jeopardy Assessment by Abandoning the Ground of Fraud, the Three Year Statute Came Into Play

Under Code Section 6861(g) after an abatement of a jeopardy assessment the Statute of Limitations must be calculated as though there were no jeopardy assessment. The three year Statute of Limitations provided by Int. Rev. Code §6501(a) then applies. The Commissioner's attempted disallowance of exemption under §911 as well as all of the other of Commissioner's contentions therefore fall because of the operation of Section 6501(a). The Commissioner's argu-

ment for the operation of the six year period provided by Int. Rev. Code §6501(e) is no more valid than any other claim of the Commissioner. §6501(e) can only operate if the taxpayer omits from his gross income an amount in excess of 25% of the amount of gross income stated in the return. The Government cannot now claim this 25% amount because it was also based upon failure to file, fraud and inadequacy of records.

It must be emphasized, however, as pointed out in Petitioner's Opening Brief, page 9, that IRC §6501(e)(iii) provides that in determining the amount omitted, there shall not be taken into account any amount disclosed in the return or in a statement attached to the return.

In claiming exemptions under IRC §911, Mr. Robida disclosed the sums which the Commissioner now seeks to disallow as exempt. (I-R. 68, 74, 81, 86, 93, 98, 103).

THE COMMISSIONER HAS IN EFFECT CONCEDED MR. ROBIDA'S POSITION ON THE MAIN CONTROVERSIES IN THIS CASE

1. The Commissioner Found on or Before December 19, 1962, That Jeopardy Did Not Exist and That There Was No Ground for Deficiency Determination. At That Time He Abated the Assessment Despite His Claim to the Contrary

(a) After IRC Finds No Jeopardy Exists, Section 6861(g) of the Internal Revenue Code Provides That Period of Limitations Be Determined as If No Jeopardy Assessment Was Made

"(g) Abatement if Jeopardy does not Exist. —The Secretary or his delegate may abate the jeopardy assessment if he finds that jeopardy

does not exist. Such abatement may not be made after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with the Tax Court, after the expiration of the period for filing such petition. The *period of limitation* on the making of assessments and levy or a proceeding in court for collection, in respect of any deficiency, *shall be determined as if the jeopardy assessment so abated had not been made,* except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the day on which such jeopardy assessment is abated." (Emphasis added)

(b) IRC Found Jeopardy Did Not Exist

When, on December 19, 1962, the Commissioner wrote "The income tax returns to which you refer in your letter, have been located" (Appendix B, page xxvi), he then found that jeopardy did not exist within the meaning of Int. Rev. Code §6861(g).

(c) IRC Continued to Assert the False Fraud Claim

Thereafter, in his answer and up to the time of trial, the Commissioner clung to his false claim of fraud, thereby gaining an advantage with respect to the statute of limitations to which he was not entitled. Since his entire position was based on this claim of fraud, the Commissioner by steadfastly maintaining it also willfully and wrongfully refused to refund the monies which he had seized and refused to admit the abatement to which Mr. Robida was then entitled.

(d) IRC Cannot Exercise Discretion to Deprive Taxpayer of Statutory Rights

Any exercise of discretion granted by law, whether exercised by the courts or by some other branch or department of the Government, must not be done in such a way as to deprive the taxpayer of statutory protections conferred by Congress, or as to deprive him of due process of law under the Fifth Amendment.

Section 6861(g) recognizes that the Commissioner's discretion in determining when to abate an assessment cannot be done in such a way as to deprive the taxpayer of the benefit of the statute of limitations.

The words "if he finds that jeopardy does not exist" cannot be construed to mean that the Commissioner can both find and not find, at the same time and with relation to the same matter, so as to deprive the taxpayer of his rights under the Code.

When the Commissioner found that the grounds for jeopardy assessment (failure to file, which was the basis of fraud) did not exist (December 19, 1962, letter, Appendix B, page xxvi) he could not at the same time hold the position that jeopardy did exist and thereby deprive Mr. Robida of the benefits of the statute of limitations.

The provision of that section requiring application of a different period of limitations in the event of an abatement clearly shows that the discretion as to abatement must be exercised with regard to statutory protections. If by use of assessment procedures

grounded on fraud the Commissioner avoids the ordinary three year period of limitations prescribed by §6501(a), thus depriving the taxpayer of the protection of that statute, and then finds that there was no fraud and hence no ground for the assessment, the Commissioner must, in order to give the taxpayer the benefits which Congress clearly intended, recognize an abatement. Otherwise he would have the power to thwart the intent of Congress by adopting two inconsistent positions at the same time and on the same subject, thus working an injustice. That is exactly what the Commissioner has done in this case by first making and then maintaining a false claim of fraud.

The Commissioner could have used statutory procedures to file a new notice of deficiency so as to protect the Government on the statute of limitations. He did not use such procedures but instead chose to maintain a false position to deprive the taxpayer of statutory protections. The Commissioner must now accept the consequences of that choice.

2. Respondent Admits Access to Robida's Records

In a footnote on page 15 of his Brief, the Commissioner makes his answer to Petitioner's Opening Brief. The Commissioner attempts to dispose of the burden of proof-records issue in the last sentence of that footnote by saying that the taxpayer did not choose to make a formal demand on the Commissioner for "these photostats". Nowhere does the Commissioner deny or seriously attempt to traverse the allegations concerning his records contained in Mr.

Robida's affidavit in support of his Motion for Judgment although it was certainly within the power of the Government to do so through Mr. Dody of OSI or Mr. Hayes of CID (see page 53 of Commissioner's Brief), or through any of the various personnel of the Office of International Operations, the Revenue Service representative in Bonn or various German officials with whom they dealt. What they were in a position to deny and did not deny should be taken as true.

3. Respondent Admits Withholding Records From Robida

The affidavit of Ciranni submitted by the Commissioner in opposition to Mr. Robida's affidavit and Motion for Judgment in no way contradicts Mr. Robida's statement that the records that were shown to him by Mr. Ciranni were incomplete; that he was not permitted to handle them for any appreciable length of time; that Mr. Ciranni indicated that the Government might have other records but could not show them to Mr. Robida; that Internal Revenue Service agents would neither confirm nor deny that they had additional records in Washington or elsewhere; that Mr. Robida was only allowed a brief inspection of certain photostatic copies at the Tax Court hearing in San Francisco.

What the Government is in essence doing is giving Mr. Robida momentary glimpses of what are claimed to be photostats of fragmentary records and then damming Mr. Robida because he refuses to accept them as either complete or correct.

The Government's attempted disclaimer in that footnote of any responsibility for Robida's records will not wash. The mere fact that the Government now claims to have some photostats and some originals of Robida's records shows that they had access. The interdepartmental letter of August 15, 1963 (page 49 of Respondent's Brief), shows that the Government has long had access to the records. The letter of May 3, 1966 (page 53 of Respondent's Brief) shows that originals were no particular problem to the Government.

4. The Government Has Guilty Knowledge of the Seizure of Robida's Records

Mr. Ciranni's remark to the Court on page 56 of Vol. II of the Reporter's Transcript that he knows the answer to Robida's mistreatment in Germany confirms Robida's repeated claim throughout the trial and his claim on page 2 of his affidavit that his records were seized by the United States Government and the German Police acting in concert. It will not do for the Commissioner now to claim the benefits but disown the burden.

In that footnote the Commissioner makes an odd attempt at exculpation by saying that he did not use any of the photostats of the taxpayer's records held by the German Police in computing the net worth statement since the record seizure came after the deficiency notice. What that has to do with the case is hard to see, but it does show that the Commissioner is hard put to find an argument. He seizes upon the circumstance that on page 3 of his Opening Brief Mr.

Robida's attorney indicates that the Germans got the records from the Internal Revenue Service. Of course, Mr. Robida's claim right along has been as stated on page 2 of his affidavit that his records were seized by the United States Government and German Police. Perhaps Mr. Dody of the OSI or Mr. Hayes of the CID would know something about that.

The Commissioner's idea of fairness apparently is encompassed in that paragraph of the footnote appearing on page 16 of his Brief wherein he indicates that in the "interest of fairness, since the taxpayer was not represented by counsel in the Tax Court, on May 13, 1966, counsel for the Commissioner furnished the taxpayer's counsel with a Xerox copy of the photostats of the taxpayer's five diaries . . ." and offered to remand the case and allow Robida to use the copies of those five diaries. This magnanimity is somewhat lessened by the Commissioner's observation in the last sentence of the first paragraph of that footnote where he indicates that the taxpayer did not choose to make a formal demand on the Commissioner for "these photostats". One wonders what good such a demand would have been to Robida when he indicates on page 5 of his affidavit that he was not allowed to see his records although he demanded that they be returned to him many, many times. Robida did make a formal demand (See I-R. 36).

5. The Commissioner Wrongfully Made the Statute of Limitations Covering Fraud Appear to Be the Controlling Statute

The Commissioner's argument with reference to records is akin to his argument with reference to the

Statute of Limitations. Up to and including the time of trial, the Commissioner relied upon fraud (Int. Rev. Code §6653(b)) for which Int. Rev. Code §6501(*c*)(3) allows an assessment at any time. So long as the government continued to persist in its allegations of fraud, knowing that the basis for fraud was false, §6501(*c*)(3) appeared to be the applicable statute. But when the Commissioner at time of trial for the first time announced his abandonment of fraud so that §6501(*c*)(3) was clearly no longer applicable and §6501(a) became the controlling statute, Mr. Robida then being deprived of his records and the Court disclaiming any jurisdiction to deal with the wrongful assessment, Mr. Robida was hardly in a position to go about amending pleadings.

Since the government can no longer maintain its false position of fraud; and its deficiency determination and jeopardy assessment of August 14, 1962, have been abandoned, it is now open to Mr. Robida for the first time on this appeal to apprise the Court that any new assessment or deficiency determination are barred by Int. Rev. Code §6501(a).

CONCLUSION

Whatever the reasons the government might have had for its treatment of Mr. Robida and no matter how sincere Mr. Ciranni or any other of the Commissioner's counsel or agents may have been throughout the history of this case, it now seems abundantly evident that fairness is a commodity which can now

be extended to Robida only by a Judgment and Order of This Honorable Court returning the moneys which were seized from him under cover of fraud, together with interest and costs as provided by law.

Dated, San Francisco, California,
November 1, 1966.

Respectfully submitted,
JOHN R. SWENDSEN,
Attorney for Petitioner.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOHN R. SWENDSEN,
Attorney for Petitioner.

(Appendices Follow)

Appendices.

Appendix A

PETITIONER'S REPLY TO THOSE PORTIONS OF RESPONDENT'S BRIEF WHICH WERE NON-RESPONSIVE TO THE ISSUES ON THIS APPEAL

A. Respondent Misstates the Issue

Respondent says (Brief 14) that the issue is whether there was evidence to support the Tax Court's Judgment.

Whether there was evidence to sustain the Tax Court findings is not the issue. No matter how much evidence was produced, the Tax Court's judgment cannot stand for the reason that the Government deprived Mr. Robida of his records and he had no means to counter anything the Government might have done or any evidence it might have adduced. The issue is remanding or judgment for Robida.

Outside of the net worth statement itself, the only evidence introduced by the Government was the testimony of Mr. Shamberger, whose testimony begins at page 101 of the Reporter's Transcript. Nowhere in that testimony is there any attempt to establish an opening net worth as required by *U. S. v. Eley*, 11 AFTR 2d 711. When Mr. Robida asked Mr. Shamberger whether he could say if all the account balances are accurate at the time the sheet was made, Mr. Ciranni objected and the Court ruled that Shamberger did not have to answer because the question was beyond the scope of direct examination. (II-R. 104) That appears to be the extent of the foundation laid for the net worth statement.

B. Respondent Erroneously Assumes That He Was Entitled to a Presumption of Correctness in His Jeopardy Assessment and Tax Determination

On page 19 of his Brief, the Commissioner contends that the approval by the Tax Court of his determination of opening net worth has not been shown to be clearly erroneous and should be sustained. Throughout his Brief, the Commissioner appears to rely upon a presumption of correctness. By assuming that presumption, the Commissioner attempts to impose upon Petitioner the burden of overcoming it. The Commissioner has not cited one statutory enactment, judicial decision, or even regulation of the Commissioner himself, to the effect that when the Commissioner has sole access to a taxpayer's records there is any entitlement to the presumption. The Commissioner has not cited and doubtless cannot cite any authority to counter *U. S. v. Heath,* 147 F.Suppl. 877, 51 AFTR 630 (affirmed 9th Circuit 1958 in 2 AFTR 5627, 260 F.2d 623), announcing the rule that the government's failure to produce the records it had access to carries a strong presumption that the records would be against the government's position.

Apparently relying upon a presumption that everything that the Commissioner does or says is correct, the Commissioner on page 20 of his Brief argues that the opening net worth for 1956 was proved by a stipulation for the closing net worth of 1955. There is no such stipulation in the record. The Commissioner cites *Cefalu v. Commissioner,* 276 F.2d 122 (CA 5th); *Shaw v. Commissioner,* 252 F.2d 681 (CA 6th); *United*

States v. Fenwick, 177 F.2d 488 (CA 7th) in support of his position.

In *Cefalu* as in the instant case the government's case was based upon fraud. In *Cefalu* the Court stated "there is no presumption of correctness attached to the Commissioner's findings on fraud".

Shaw is not in point. The stipulation made for purposes of that case was not in issue.

In *Fenwick,* an income tax evasion case, the Court held that the government has the burden of proof and that this burden never shifts to the defendant. In *Fenwick,* a judgment of conviction was reversed, the Court quoting from *Bryan v. United States,* 175 F.2d 223 (CCA 5th) wherein the Court said:

> "The net worth expenditures method of establishing net income, sought to be applied in this case, is effective only if the computations of net worth at the beginning and at the end of the questioned periods can reasonably be accepted as accurate."

The government certainly did not sustain any such burden in the Robida case.

In *Holland v. United States,* 348 U.S. 121, cited by Respondent on page 20 of his Brief to support its net worth calculation, Justice Clark in commenting on the net worth method stated:

> "One basic assumption in establishing guilt by this method is that most assets derive from a taxable source, and that when this is not true the taxpayer is in a position to explain the discrepancy."

Robida was not in such a position.

C. Respondent's Claimed Stipulation as to Opening Net Worth Is Non-Existent

On page 20 of his Brief, the Commissioner cites II-R. 68, 73-74 and I-R. 36, 177 for the proposition that Mr. Robida stipulated to an opening net worth in 1956.

II-R. 68 contains nothing remotely resembling a stipulation. II-R. 73 to 74 amount to a question and answer quarrel between Mr. Robida and Mr. Lee of the government. There is no stipulation there.

In I-R. at page 36, there is a Request and Notice by Mr. Robida wherein he states that he made a prior settlement with the Government for the years ending with 1955 and made the settlement under protest, believing that he did not owe any tax and that it was understood in 1957 that his net worth statement was not complete. That is not a stipulation.

It is to be noted that in that Request and Notice on page 36, Mr. Robida requests that his records seized in Wiesbaden, Germany, be made available to him.

I-R. 177 does not contain anything that can be possibly considered a stipulation.

D. The Commissioner Had the Burden of Proving That Income Reported as Exempt Under Internal Revenue Code Section 911 Was Not Exempt. The Commissioner Failed to Sustain That Burden

Once again, the circumstance of Robida's records comes into play. Robida's records if made available to him would show not only where he was from time

to time, but from whom and how he derived his income. The government having access to those records and having failed to produce them failed in its burden of proof.

E. The Evidence Shows That Robida's Income Was Exempt

Both the Commissioner and the Tax Court assumed that monetary gains derived from the skillful manipulation of coin-operated machines in such a manner as to eliminate the element of chance constituted gambling income. However, Int. Rev. Code §4462 (a)(2) defines slot machines as an object that operates by "the application of chance". The machines manipulated by the Petitioner (Respondent's Brief 24; II-R. 52, 53, 61, 66) were not "slot machines" as defined in Int. Rev. Code §4462(a)(2) since the application of chance did not apply to them. Monetary gains made by Petitioner's ability to eliminate the application of chance were, therefore, not gambling gains under Revenue Ruling 55-171, 1955-1 Cum.Bull. 80, 87.

Throughout the trial both counsel for the Respondent and the Tax Court imply that there is something reprehensible about skillfully manipulating coin operated machines. Surely, the person who by skill is enabled to eliminate the application of chance is behaving in a more intelligent, rational and acceptable manner than the person who constantly loses his hard earned money.

The Petitioner did not gamble. His monetary gains, if taxable at all, must by the process of elimination

have constituted earned income under Int. Rev. Code §911. No one has ever been able to prove that Petitioner manipulated coin operated machines in other than a completely legal manner (II-R. 33). In fact, the Appellant put on a demonstration before a group of Air Force Generals that proved to them his ability was a legal one, and the demonstration resulted in the dropping of charges against Petitioner (II-R. 62). The fact that Petitioner made substantial earnings from coin operated machines and could prove to the satisfaction of very high ranking and responsible Air Force Officers that he did possess extraordinary skill in pulling the handle in such a manner as to hit a jackpot shows that Petitioner was not gambling. His monetary gains constitute earned income as would that of any other self-employed person.

Since Petitioner's monetary gains were not gambling income, they would not be taxable at all unless they are "earned income" under Int. Rev. Code §911. For Petitioner's monetary gains to be taxable, they must come under Int. Rev. Code §61 defining gross income. Thus, Respondent's argument (Reply Brief, page 25) proves too much. If an overly restrictive interpretation is given to "earned income", then Petitioner's monetary gains, which are clearly not gambling income, would not be earnings at all and thus not part of gross income under Int. Rev. Code §61. Petitioner, however, has always treated and considered that his monetary gains constitute income under Int. Rev. Code §61, which would then neces-

sarily be exempt as earned income under Int. Rev. Code §911.

F. Mr. Robida Was Never Given an Opportunity to File the Bond to Stay Jeopardy Assessment

At page 31 of his Brief, the Commissioner argues that institution of Tax Court proceedings and this appeal do not operate to stay the Commissioner from enforcing a jeopardy assessment in the absence of a bond.

Mr. Robida was never given a chance to file a bond. On August 29, 1962, by way of levy, the Government collected more than is now admittedly due (I-R. 147-169). It was not until September 18, 1962, that the IRS mailed a notice of deficiency to Robida at Wiesbaden, Germany (I-R. 43).

More important still is the circumstance that there is no showing that a notice of demand for payment was ever made upon Mr. Robida as required by Int. Rev. Code §6861(a). As pointed out elsewhere in this Brief, the requirement for a demand for payment is jurisdictional and without it the Government's case fails entirely.

Appendix B

In the United States Court of Appeals
For the Ninth Circuit

No. 20,592

DANIEL A. ROBIDA, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

MOTION IN OPPOSITION TO MOTION TO REMAND AND MOTION FOR FINAL JUDGMENT

Petitioner represents and moves as follows:

In Fairness to Petitioner, Respondent's Motion to Remand Should be Denied

In his Motion to Remand, Respondent indicates a willingness to be fair (paragraphs 5 and 6) to Mr. Robida, by making available "a Xeroxed copy of photostats" of certain diaries of Petitioner. As appears from Mr. Robida's Affidavit in support of this Motion, those records are incomplete and inadequate and can no longer constitute an evidentiary basis for any contention of either party.

The case can now be disposed of on matters of law, and this Court has adequate jurisdiction to do so, as appears more fully hereinafter. To remand under these circumstances would not be promotive of the ends of justice but would continue a history of unfairness which is now too long.

The Motion of the CIR Assumes That Issues of Fact Remain Upon Which Mr. Robida had a Burden of Proof

Respondent, in his Motion to Remand, assumes (p. 3) that the records which he now offers to make available would be used by Mr. Robida, the Petitioner, to prove his contentions at a further trial before the Tax Court.

That assumption is wrong on two counts. In the first place, as Petitioner points out in his Opening Brief (p. 10), the CIR at the time of trial abandoned all of the grounds upon which his Notice of Deficiency and Jeopardy Assessment was based. Any new theory he might then have advanced was subject to proof by the Commissioner. He failed in that and cannot now receive a new trial to correct his failure. He has not appealed.

Second, and more important, it appears that there was no issue before the Tax Court and nothing for it to do but render judgment in favor of Mr. Robida.

Since the Commissioner's Notice was based upon fraud, failure to file and inadequacy of records, and since all of those grounds were abandoned, he in effect abandoned his Deficiency Notice and Jeopardy Assess-

ment. As shown on RT 17, lines 12-13, the fraud allegation was based on failure to file. At the same time, the grounds of failure to file necessarily constituted the basis of the grounds of inadequacy of records. Moreover, the records must be assumed to be adequate since CIR had possession and control of them, but did not introduce them in evidence in order to show a basis for the net worth calculation.

There was nothing left for Mr. Robida to contest. No issue then remained before the Tax Court. There was no burden of proof to sustain.

After the CIR Abandoned his Deficiency Notice, the Tax Court had no Jurisdiction to Make Findings or to Render a Decision Other Than in Conformity with the Commissioner's Confession of Error

After the IRS gave its September 18, 1962 Notice of Deficiency and Jeopardy Assessment to Robida (CT 44), the Tax Court had jurisdiction under Internal Revenue Code §§7442 and 6213(a) to entertain his Petition for Redetermination. The language of §6213(a) is as follows:

> "(a) Time for Filing Petition and Restriction on Assessment.—Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the

deficiency. Except as otherwise provided in section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

"Lack of jurisdiction of a federal court touching the subject matter of litigation cannot be ignored by a federal appellate court. So a judgment or order rendered without jurisdiction or authority *must ordinarily be reversed,* and an appellate court may of *its own motion reverse* such a judgment or order. This rule applies where the record does not affirmatively show jurisdiction; and it has been applied to lack of jurisdiction of the subject matter." 36 C.J.S. Fed. Ct. §301(15) and cases cited therein. (Emphasis added)

When the CIR abandoned the grounds upon which the Deficiency Notice and Jeopardy Assessment was made (failure to file, fraud, inadequacy of records—CT 45, 48, 51, 54, 57, 60), it abandoned the deficiency and the jeopardy assessment, and in effect abated the jeopardy assessment under §6861(g).

At that time the basis for the Tax Court's jurisdiction ceased to exist, except to render judgment in accordance with the abandonment and abatement by the CIR.

It is Now in Order for This Honorable Court to Render Final Judgment

"A judgment will ordinarily be reversed on a confession of error by appellee, respondent, or defendant in error." 36 C.J.S. Federal Courts §301(15), Citing *Thomas v. U. S.*, C.C.A. Miss. 96 F.2d 767.

"A judgment or decree on the merits in a cause wherein jurisdiction is not affirmatively shown on the record will be reversed by the court of appeals with instructions to dismiss the suit for want of jurisdiction and without prejudice, unless an amendment shall be made so as to exhibit a case within the jurisdiction." 36 C.J.S. Federal Courts §301(20) and cases cited therein.

In most cases, the reversal is made without considering the merits of the action. 36 C.J.S. Fed. Cts. §301(20). See *American Sugar Refining Co. v. Johnson* (Fla.) 60 F. 503, 9 CCA 110. Thus, where no jurisdiction is shown (and Respondent has failed to meet the burden of proof on jurisdiction), the appellate court "in such case will not, on reversing a judgment, remand the case for further proceedings, but will itself render final judgment of dismissal or nonsuit." 36 C.J.S. Fed. Cts. §301(20).

The Tax Court had Jurisdiction Under IRC §6861(c) not Only to Increase or Decrease the Amount of Deficiency, but also Abate the Assessment Completely and to Recognize the Fact of Abatement as a Matter of Law under IRC §6861(g)

IRC §6861(c) provides in pertinent part as follows:

> ". . . Tax Court shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith."

The Tax Court apparently was under the impression that it had no such power as appears from the following (RT 16, lines 5-10):

> "The Court: I want you to understand that this Court has nothing to do with the jeopardy assessment. I have no authority to hear anything about a jeopardy assessment, no authority to raise the assessment or lower it or get rid of it.
>
> I cannot do a thing about that."

Mr. Robida was understandably confused as appears from the following (RT 16, line 11 to RT 17, line 13):

> "Mr. Robida: Well, your Honor, you see, it is very confusing to me.
>
> You take this as an example. They sent the notice, the statutory notice, based upon the fact, the allegation, that I had never filed any return for the past six years, and then they proceeded to assess a fraud penalty and a tax on a sum of—well, it comes to $77,000, and I pointed out in the Petition that I had filed returns for each of the

years with the District Director in Portsmouth, New Hampshire and paid the taxes that was due.

They turned around and answered and in their answer they said I still did not file any tax returns and I was trying to cheat the Government.

Well, the fact is that I did file returns, and even at the time in November when they wrote to me and said they were aware of the fact that I had filed the returns in November of 1962, and the answer came in February 1963 saying I had not filed returns.

The inconsistencies are very hard on me to understand what is going on.

The Court: How are you going to prove you filed those returns?

Mr. Robida: Well, the Respondent is willing to admit I filed them.

Mr. Ciranni: I have already told him we had found the returns. He can't get them into evidence, but I will get them into evidence. We have copies of them here. This was the basis of our fraud allegation."

IRC §6861(g) gives the Secretary or his delegate the power to abate an assessment if jeopardy does not exist. The abandonment of all grounds for jeopardy assessment was in effect a ruling by the CIR that jeopardy did not exist. Thus, the Tax Court should have exercised its power under §6861(c) to set aside the jeopardy assessment and to order the return of all funds obtained by way of levy under an assessment admitted by the CIR to be on no adequate grounds.

Wherefore, Petitioner moves this Honorable Court for its order

1. Denying Respondent's motion to remand;

2. Making final judgment in favor of Petitioner;

3. Directing Respondent to return to Petitioner all moneys and other property seized by Respondent by way of levy or otherwise, with interest and costs as provided by law;

4. Granting any other relief that may appear to be just.

Respectfully submitted,

John R. Swendsen
126 Post Street
San Francisco, California
Attorney for Petitioner
Daniel A. Robida

Dated: July 8, 1966.

In the United States Court of Appeals
for the Ninth Circuit

No. 20592

DANIEL A. ROBIDA, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

AFFIDAVIT IN SUPPORT OF MOTION IN OPPOSITION TO MOTION TO REMAND AND IN SUPPORT OF MOTION FOR JUDGMENT

Daniel A. Robida, being first duly sworn, deposes and says:

I am the Petitioner above named. I am sure that, if my records had been made available to me at the commencement of these proceedings, they would have shown my income tax returns to be correct as filed. At this late stage of the proceedings, however, the disordered and incomplete state of my records, now in the control and possession of Respondent, would be of no use to me.

As will be made clear later on in this Affidavit, agents of the government conducted an extremely thorough and extensive investigation not only of my

records but of my personal and business backgrounds. I am convinced that the reason Respondent did not produce any of the fruits of that very intensive investigation is that the results were favorable to me and revealed nothing that would support Respondent's jeopardy assessment and notice of deficiency.

This investigation occurred after Respondent had charged me with fraud, which Respondent now claims was only based on failure to file income tax returns. (Now admitted to be false—RT 17)

The investigation obviously did not produce any evidence of fraud, and just as obviously did not produce anything which would show that my income tax liability was anything other than as reported on my returns, which are now admitted to have been filed and paid by me.

The photostats forwarded to my attorney, John R. Swendsen, by the attorneys for the Commissioner of Internal Revenue with forwarding letter dated May 13, 1966 (see Appendix B to Petitioner's Opening Brief) consist of Xerox copies of photostats of five notebooks, bound together with Acco fasteners. I am unable to say whether these photostats actually reflect my original records. The pages of these photostats appear to be out of order. Some of the pages in them I do not recognize as mine. These five bound photostatic copies do not constitute all of my original records and would be substantially useless to me in any court proceeding.

The records which I had and which were seized by the United States Government and the German Police

were sufficient to fill an ordinary grocery box. I had at least ten notebooks of the general kind indicated by the photostats sent to Mr. Swendsen on May 13th. I maintained four separate sets of notebooks, each containing different kinds or materials, as follows:

1. *Travel Books:* Containing names of places visited, with dates and names of individuals with whom I transacted business, including pupils whom I taught; names and addresses of persons I could rely upon; names and places of clubs I visited; other material that I cannot now remember.

2. *History or Diary:* Containing notations of incidents concerning myself and other persons that occurred on Army or other Government bases which indicated corruption in NCO clubs and the like.

3. *Auto Log:* Containing mileage traveled; automobile expenses and other expenses shared with other people in the course of traveling and obtaining lodging and the like.

4. *Income Records:* Containing notations of gross and net income from overseas and U.S. sources, plus a summary of expenses from the Auto Log.

All of these books together gave a complete picture of my income and financial transactions from approximately 1947 to 1962.

Other records which were seized consist of the following:

1. Letters to banks and insurance companies; money order stubs; cancelled checks; copies of bank drafts; acknowledgments of moneys owed to me but not paid.

2. Lists of family names with birth dates, marriages, etc.

3. Automobile, airplane and radio licenses; operators licenses; seamen's licenses; medical records, including records of inoculations necessary for travel.

4. Statements sworn to before American Consuls from various persons pertaining to moneys owed and moneys earned and the nature and origin of debts.

5. Photographs of people and places, including clubs where I earned money. The photographs contained notations of dates, places and other material.

At no time, after all of these records were seized, was I permitted to have them or inspect them, except for the momentary and cursory occasions when either German or American officials and agents would ask me whether certain records were mine. They did return my seamen's papers, however.

When I was incarcerated in Wiesbaden, Germany, my records were seized, but I was not present at the time.

In jail, on at least 20 occasions, I was questioned by both American and German officials and agents. They questioned me about all kinds of things, including my records, and did show me, but did not permit me to inspect, income tax records which I had just then mailed to my brother in the United States. They admitted to me at that time that they had taken that envelope and those records out of the mail. Those records sent to my brother were very important to my case because they contained orderly summaries, show-

ing that my income as reported and my tax as paid were correct.

On three separate occasions, while I was incarcerated at Wiesbaden, I was taken out of the jail and escorted by both German Police and U.S. military personnel (OSI personnel and CID personnel from the Army and the Air Force) to the U.S. Air Force Base at Wiesbaden and there I was questioned extensively about slot machines and my entire life. On the first occasion I saw a box full of papers which appeared to be mine. One of the American agents questioning me took a small notebook, which I recognized as mine, and placed it before me. He opened it to a particular page and said "What does this page mean?" When I went to reach for it, the agent made a gesture and said "Don't touch the book". I then said "Well, it's my book". The agent then said "Well, it belongs to the United States Government now and you will never see it again as long as you live". That was the last time that I saw the originals of any of my notebooks.

On the other two occasions when I was taken to the U.S. Air Force Base at Wiesbaden from the Wiesbaden jail, my records were present, but I was not allowed to see them, although I demanded that they be returned to me many, many times. On each of those occasions, the agents questioning me tried to get me to sign a statement to the effect that I was not under threat, intimidation or coercion. I told them that I would not sign any such statement because I was under threat, intimidation and coercion. On all three

occasions, both German and American officials were present. On at least one occasion, they had a tape recorder going, and on at least one of the occasions they had a typist there who typed the interrogation as it progressed.

On a fourth occasion, I was taken from the Wiesbaden jail, again escorted by substantially the same kind of personnel, and taken to the U.S. Army Base at Darmstadt where I was made to demonstrate before American Generals my skill in manipulating slot machines without any tools or devices whatsoever, so as to eliminate the element of chance.

I was never given any court hearing at any time, either before or after my release from jail.

After my return to the United States, I had several conferences with Internal Revenue Service personnel on Sutter Street in San Francisco. At some of those conferences I was shown some photostats and asked if they were my records. While they had a general appearance that would indicate that they might be my records, I could not positively identify them for a number of reasons. One reason was that they were all mixed up as to pages. Another reason was that I was not permitted to handle any of them for any appreciable length of time. A further reason was that some of the notations in those photostats were such that I could not identify them as being mine.

None of the records that I saw during those conferences were complete. Mr. Ciranni (who was present at some of these conferences) stated that the Govern-

ment might have other records of mine, but that he could not show them to me. He said that these other records might be in Washington. When I asked whether they had the originals, neither Mr. Ciranni nor any of the other Internal Revenue Service agents would say that they either had them or did not have them, and when I made further inquiries, they would neither confirm nor deny that they had additional records in Washington or elsewhere.

On the morning of the Tax Court hearing in San Francisco, Mr. Ciranni showed me what purported to be a great pile of my records, but he would only let me briefly inspect certain of the photostatic copies of notebooks.

My memory cannot now be refreshed as a result of the present state of my records and other papers that were seized by American and German agents. I could not now safely rely upon them in any court proceeding. I am convinced that my records are no longer reliable.

/s/ Daniel A. Robida
Daniel A. Robida

Subscribed and sworn to before me at San Francisco, California, this 8th day of July, 1966, by Daniel A. Robida.

(Seal) Wilson Reid Ogg,
Notary Public, State of California,
Principal Office, Alameda County.

My commission expires March 24, 1968.

In the United States Court of Appeals
For the Ninth Circuit

No. 20,592

DANIEL A. ROBIDA, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

SUPPLEMENTAL AFFIDAVIT OF DANIEL A. ROBIDA IN SUPPORT OF MOTION FOR JUDGMENT

State of California
County of San Francisco—ss.

Daniel A. Robida, being first duly sworn, deposes and says:

I am the Petitioner above named.

After the Internal Revenue Service advised me that they were charging me with fraud on the grounds that I had not filed my income tax returns for the years 1956 through 1961, I wrote them a letter dated December 6, 1962, advising when and where I filed the returns for those years.

I received a reply dated December 19, 1962, from the San Francisco District Director of the Internal Revenue Service acknowledging that the returns had been located. A photostatic copy of said letter is attached hereto and made a part hereof. Said photostat is a true copy of the original in every way except for the marginal notations which are in my own handwriting.

/s/ Daniel A. Robida
Daniel A. Robida

Subscribed and sworn to before me at San Francisco, California, this 20th day of October, 1966, by Daniel A. Robida.

(Seal) /s/ Wilson Reid Ogg
Notary Public, State of California
My Commission Expires March 24, 1968

Read, Use, Remember!!

Letterhead of
U.S. Treasury Department
Internal Revenue Service
District Director
San Francisco 2, California
100 McAllister Street
Dec. 19, 1962

In Reply Refer to
A:R:150D:JCB:Room 1312

Mr. Daniel A. Robida
c/o Kurhotel Savabini
Paulinenstrasse 4
Wiesbaden, Germany

Dear Mr. Robida:

This is in reply to your letter dated December 6, 1962, in which you acknowledge receipt of our letter dated September 18, 1962. Our letter advised you that one hundred and fifty days are permitted for the filing of a petition to the Tax Court of the United States.

The income tax returns to which you refer in your letter, have been located. The tax reported on these returns would have a negligible effect on the tax, penalty and interest recited in our letter. This would not, in any case, have had the effect of setting aside the jeopardy assessment.

The provisions of the Internal Revenue Laws applicable to jeopardy assessment allow the taxpayer to protest by means of a petition to the Tax Court of the

United States. In your case, this must be done by February 18, 1963. The law does not provide for an extension of time for filing the petition. This office cannot set aside the assessment, nor entertain a protest, the matter being wholly within the jurisdiction of the Tax Court.

Enclosed for your convenience is an extra copy of the adjustments leading to the assessments made, which you requested. The original of this was furnished to you with our letter of September 18, 1962.

Very truly yours,
Claude F. Salter
Chief, Audit Division

Enclosure

30-Day Room 1312—DAR

IRS Answer was filed Feb. 20, 1963 this proves IRS lied when they stated I had not filed returns in their answer at least—DAR